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The House that Franklin Built

By JOHN H. COVER*

ALTHOUGH Jack got full credit in the nursery rhyme, it is probable that his neighbors helped him erect his house, bringing tools, horses, and human brawn to the building bee. But when Jack's grandson decided to build a home he found a scarcity value attached to land, a building code to control his plans, a city zoning ordinance limiting location, supply dealers specializing in the raw products, construction contractors to manage the job, labor unions to set wage rates and craft functions, real estate agents to negotiate for sites, financing institutions to arrange for funds, and a local government waiting to tax the results.

This complexity of modern home-building is an outgrowth of population increase and concentration, mechanical development, a degree of raw products depletion, and specialization which are common to most industries and occupations. The massing of human population has not augmented the cooperative tendency of its individuals. Contractors, architects, cement manufacturers, plumbers do not contribute their skills in exchange for a feast and an evening of song.

Establishing the family fireside is one of the world's major businesses. Vast catering industries—basic materials, transportation, financing—are dependent for a large proportion of their activity and solvency upon the fluctuations of building construction. And, as is always the case when opportunities for quick profit appear, speculation has taken its economic and human toll.

President Roosevelt has had the fortune to become our chief executive in a period of rapid economic and social transition. The two approaches inevitably available and employed in Mr. Roosevelt's recent recommendations for housing legislation are protection, by restriction of others (the policing aspect) and promotion, by expansion of opportunity (the activating aspect). An example of the first is the promise of reduction of costs; of the second, the lowering of the home owner's equity requirement, for obtaining government insurance, from 20 to 10%.

Two necessities advocated as the basis for a housing campaign are need of dwellings and resuscitation of business

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and industry. To a large extent housing is a function of community development. An examination of the relations of recent federal legislation to home building and financing and to business fluctuations in a metropolitan city, Chicago, give a very practical insight into the many problems involved.

I

In interpreting the hope, frequently expressed in public print, that construction activity may prove the means of lifting us out of the recession by our boot straps, it is important to note that the present relation of building to general business conditions is unusual. Just now the unusual is advantageous. We are quite accustomed to the difference in length of time required to produce rabbits and cattle; similar contrasts exist between the lengths of general business cycles and building cycles. The period intervening between depressions in business is short; in construction activity, long. In addition, fluctuations between points of maximum boom and low points are greater in construction activity, while inclines and declines are usually more abrupt. Much to our annoyance, both general business and building chose to reach their respective depression pits simultaneously in 1933. But having survived that calamity we now realize that simultaneous recoveries may be enjoyed.

Starved by war-time restrictions upon construction and by high-level costs, building did not get under way until the depression year, 1921. The average dollar volume of construction in Chicago for the nine years beginning in 1921 was three times as large as for the average of the preceding eight years. Then the collapse occurred. The estimated cost of residences constructed in Chicago in 1926 was $242 millions; in 1933 a low of a little more than one-half million dollars was recorded, a drop of 98.8%. The 1937 estimated expenditure aggregated only $6,628,320.

Stock speculation in the late twenties is a fact of general recognition. But the even more serious spree of real estate speculation has been realized only in certain dramatized versions. Of the persons (not business proprietors or corporations) filing individual bankruptcy petitions in the Chicago area in 1930 and 1931, failure was attributable in 20% of the cases primarily to speculation. Only 1/5 of these speculation bankruptcies was caused by stock market flings. One-half of this group purchased equities in real estate hoping to gain by a rising market. But most serious of all, 3/10 lost their own homes because they accepted mortgage obligations far beyond all possibility of fulfillment.

Chicago's recent dearth of construction may be a compensation for the over-indulgence of the twenties, which in turn was a reaction from the deficiency of the war and early post-war period. In planning for a building boom it is important, then, to establish safety valves. If it were possible to estimate consumer needs on a long-time population basis, potential demand would provide our best criterion. Frequently, a glance into the past gives a perspective which reduces our present concerns to their proper proportions.

Despite wide intervening fluctuations, a healthy growth in Chicago building values occurred from 1882 to 1912, averaging between 3 and 4% annually. The increase from 1919 to 1924 was about proportionate to the increase from 1888 to 1892, although the actual dollar change in the more recent period was five times as great as in the earlier period. Unfortunately, irregularity in the timing of depressions leaves few clews for forecasting cycles. Peaks of

building activity in Chicago were reached in 1892, 1916, and 1926. The first period covers 24 years; the second, 10. Pits of inactivity were recorded in 1882, 1900, 1918, and 1933; here the timing differences are 18, 18, and 15 years.

Turning to business, we find peaks in 1892, 1900, 1906, 1909, 1913, 1916 and 1929; and pits in 1893, 1896, 1904, 1908, 1911, 1914, 1921 and 1933. The contrast is obvious.

The wide range of fluctuations is illustrated by changes in the value of one-family dwellings. If the average monthly value of 1936 is taken as 100%, the highest point was reached in October, 1925 with 1,389%, and the lowest in January, 1933 with 1%. Fluctuations in general business have no comparable range. Probably the maximum variation from prosperity to depression has not exceeded 60% of any fixed point.

Building is logically in position at the present time for a vital surge upward. The obstacles will be detailed later. Its danger as a priming factor for business recovery lies partly in the variations just discussed and in elements many of which are touched in recent federal legislation.

II

It is important in estimating the effects of the new housing legislation to stamp it clearly as a mortgage-insurance statute. Introduced simultaneously into the Senate by Robert F. Wagner, New York, and into the House of Representatives by Henry B. Steagall, Alabama, the bill was described as "an Act to amend the National Housing Act, and for other purposes." The original Act established the Federal Housing Administration which, as President Roosevelt explained in his message to Congress of November 29, 1937 "insures mortgages in certain types of housing, but itself makes no loans."

A mortgage-insurance fund is established and is continually augmented by premiums paid by borrowers who obtain loans from private lending institutions. The Federal Government insures these loans against default, guaranteeing against loss over and above recoveries from the sale of defaulted properties and the amounts accumulated in the insurance fund itself.

Present approaches to the expansion of building and the control of its development, therefore, are to be through mortgage insurance. Hearings initiated by Congressional committees brought Federal Housing Administrator Stewart McDonald, Reconstruction Finance Corporation Chairman Jesse Jones, and Federal Reserve Board Governor Marriner S. Eccles to the bill's support. The emphasis of these proponents immediately dubbed the measure as the "bankers' bill." Mr. Eccles believes that the provisions of the bill should operate satisfactorily as regards commercial banks, and admitted that thrift institutions of the savings, building and loan type probably could not operate under the rates proposed. Mr. McDonald testified that these institutions charged exorbitant interest rates. Rumor has it that the administrators of the Federal Home Loan Bank Board, which functions primarily in support of federally chartered savings, building and loan associations, first learned of the new proposals when the President's address was read to the Congress.

It is estimated that about 65% of the 1936 FHA insurance business was derived from commercial banks; the balance was distributed among life insurance companies, mutual savings banks, savings, building and loan associations, mortgage bankers, and other lenders. But of great significance is the fact that the FHA insured only about 17% of the

home mortgage loans made in 1936, and that probably not more than 12% of all institutions making mortgage loans in that year made use of FHA insurance. Representatives of thrift and home-financing institutions claim they have financed ⅔ of the loans made on homes since 1930. These loans have been made to one and one-half million borrowers with funds obtained from six million share-investors. It is apparent that adjustments in legislation or in the operation of these leading institutions are necessary if these associations are to become effective agents under the National Housing Act.

Two main classes of transactions were included in the operations of the original National Housing Act: those in which single houses were security for loans, and those in which limited-dividend companies obtained loans to develop rental housing projects. The Roosevelt revisions incorporated in the recent amending legislation have three objectives: "(1) to effect further reductions in financing costs; (2) to extend the insurance of mortgages to types of housing operations not now adequately provided for in the act; (3) to make the funds of institutional and individual investors more easily available for the financing of large-scale operations."

After considerable delay, the passage of different proposals by the House and the Senate, and a careful reworking by a conference committee of the two legislative bodies, the House passed H. R. 8730 on January 21, as "The National Housing Act Amendments of 1938."[1] This act became law with the concurrence of the Senate and with the approval of the President, February 4, 1938.

President Roosevelt referred to the burden of the total interest charge on home-purchasers over the long period of years required to liquidate the loan. To reduce this cost to the consumer, whether borne directly in the form of mortgages or indirectly through rentals, the new legislation permits insuring of loans only if the lending institution charges a maximum of 5%, a compulsory reduction of ½ of 1% from the previous maximum. In assisting this scaling down of charges, the mortgage-insurance premium may be fixed as low as ½ of 1% on the balance of the insured mortgage at the end of each computing period, instead of on the total face value. In addition, if the estimated value of homes to be built by the occupants does not exceed $6,000 and if the insurance is obtained prior to July 1, 1939, the insurance premium is fixed by statute at ¼ of 1%.

Of almost 13,000 mortgages ranging in value from $2,000 to $100,000 recorded in Cook County, principally Chicago, in 1936, about 37% bore an interest rate of 5%, and 46%, a rate of 6%. If we add the 9% of mortgages written at 5½%, we account for all but 8% of the total number recorded. In classifying by value, about 40% were written at 5% interest and 31% at 6%; approximately 10% bore 5½% interest, and 13% bore 4½% interest. The tendency is for smaller loans to bear higher rates of interest.

But it is well known that various other charges involved increase the cost, and it is estimated that the so-called 5% FHA loans actually cost the borrower from 6.4 to 7%. This aspect of the problem suggests that all advertising and all contracts specifically state the costs in total and in detail as a safeguard to the home-purchaser. Otherwise, the small salaried owner will unwittingly obligate himself for expenditures far beyond his competence.

[1] 48 Stat. 1246, c. 847, including Amendments of 1938.

In considering the so-called interest charges it is important to distinguish the portion of the rate quoted which is actually a charge for the money used (termed "pure interest") from the risk-sharing portions which include charges made as insurance against defaulting in payment of the loan or taxes and the expenses of foreclosure.

In the hearings on the bill, frequent references were made by proponents to the success of the building societies of Great Britain in making loans to home owners at low rates. In considering this fact, it is necessary to keep in mind that British societies acquire funds for lending at a lower rate of interest than is customary in the United States; that real estate taxes are not a prior lien against the property as in this country; and that foreclosures in Great Britain require about two weeks and cost a few dollars, whereas in the United States months or years are involved and the cost usually exceeds $200.

Other features, then, must be studied and improved before charges can be greatly reduced. These include the costs of court procedure and the risk that litigation and taxes may swallow up the equity residing in the mortgage.

III

It is also permitted in the new legislation to raise the insurable limit from 80%, as previously, to 90% of the appraised value of the property in instances in which loans to owner-occupants do not exceed $6,000. The purpose of this section is to encourage home ownership among moderate income-earners who have insufficient savings to make a down payment of more than $600. This objective is entirely praiseworthy, but there are many dangers involved in its application.

Estimates made by appraisers vary widely. There are wide divergencies in the criteria for estimating the current money value of property, as anyone who has suffered tax assessment can testify. At present Chicago's attempt to enlarge its airport is stalemated by the complete disagreement of three groups of appraisers as to the value of a vacant lot. Seldom do the prices paid and the appraised value agree, and the differences increase with time and with price-level fluctuations. Present values would seem inflated in a subsequent period of lower market values and lower costs. With the amount of the mortgage established and the amortization payments determined, the contract provisions would remain unaltered regardless of fluctuations in market value.

In facing the problem of depression defaults and foreclosures, it is not likely that the government, even in severe crises, would face a substantial loss. Even though disposal of properties becomes necessary under forced sale, they will yield some return; to this will be added the accumulated insurance fund before the government income is affected. Under the most unfavorable situation, the government can become a landlord and receive rental income from tenants.

Reference to British procedures by the proponents of the new bill failed to include the fact that, in the case of high-percentage loans, builders, supply dealers, and real estate operators make deposits as insurance guarantees for the loans. This participation has proved a constructive measure in stabilizing costs and values and in reducing speculative building. Moreover, while the recent American legislation is an aid to the financing of mortages by commercial banks, in Great Britain it is a rare event for banks to make mortgage loans.

IV

In planning the building of a home, the prospective owner, immersed in the enthusiasm of his goal, frequently is not aware of many of the implications involved. He desires a residence which he may call his own, and is abetted in this desire by any salesman of land, materials, or mortgage funds whom he may consult.

Let us observe the case of Anthony Brown, father of a young son and daughter, with an income of $150 per month, and holding clear title to a vacant lot. He wishes to build a house of six rooms with modern plumbing, central heating, and other conveniences. If we accept the estimate of the Federal Home Loan Bank Board for the current average cost of constructing this dwelling in Chicago—more than $7,000—it would place Anthony Brown beyond the special legislative inducements. But if we assume a maximum estimated cost of $6,000, there are still many other problems to face.

Available savings of only $600 would meet the down payment but leave nothing for emergencies. Suppose later illness should require an emergency outlay; no funds could be raised on an extension of the mortgage, and no additional mortgages could be obtained, for an equity of only 10% leaves no margin. It is to be hoped that Brown has made his first investment in life insurance; but an emergency then places his insurance in jeopardy, whether he borrows or cancels.

Based upon his current income, Brown should make an outlay—figuring payments on a rental basis—of from $30 to $37 per month. On a loan of $5,400, at the rate of 5%, a monthly instalment of $30 would require about 26 years to pay off the indebtedness. This does not include the insurance charge of ¼ of 1% on the diminishing balance of the loan. Thirty dollars a month is not a high rental to pay, but in purchasing a home it does not include taxes, upkeep, fuel, improvement of the landscaping, or those many alterations and adjustments which usually appear so essential.

Current practice prefers much shorter periods of liquidation, 11 to 15 years, because of property depreciation and changes in desirability of residential areas. In addition, the many potential improvements, such as air-conditioning which are expected to revolutionize construction in the near future, favor shorter loan periods. It is true that practices in England include long contract periods, and that many of our structures would be serviceable for 100 years or more. But this is one of the wastes of the speed of American life which is regrettable but factual, and which requires consideration. Until we stop razing dwellings still adequately serviceable to erect substitutes with additional gadgets, fads, and adornments, we shall be obliged to confront the problem of a rate of obsolescence associated with luxuries.

Should fluctuations in business conditions result in unemployment or part-time employment for Brown, the picture darkens. We have assumed as current income for Brown approximately the average weekly earnings per male worker employed in Chicago manufacturing for the peak month of 1929, $34.88. The present average is about $31. In March, 1933 the depression low was reached with an average weekly income of about $20—for those employed. Should Brown's earnings drop to $87 per month, a proportionate fall in the payments on the mortgage would bring the monthly instalment to about $17.40. But since his contract is fixed and the payments do not diminish, he has the alternative of sacrificing elsewhere, or of permitting foreclosure.

Brown's first effort will be to meet mortgage payments, even at the sacrifice of adequate nutrition. Failing, the dreams of a home vanish in foreclosure. Should he decide to take full advantage of the lethargy of foreclosure procedure, Brown may be able to continue living in his home for two or three years rent free, which may compensate him for the shattered dream.

The holder of the mortgage is obliged, in case of the mortgagor's failure to pay, to notify the FHA. Though furniture cannot be attached, it is possible for the mortgage-holder to garnishee the wages of the defaulting party. The mortgagee has the privilege of turning the case over to the FHA which usually tries to dispose of the property, settling claims and remitting to the home owner any balance. It has been the policy of the FHA not to attach wages. The mortgagee may receive, upon conveyance of title to the FHA, debentures and certificate of claim for the amount due, with interest not exceeding 3% (the present rate is 2¾%). Included in the debenture may be a maximum of $75 toward meeting foreclosure costs.

In about three years of operation, only 37 foreclosures have been obtained by the FHA, though in the same period almost 176,000 loans were insured; and though $713,562,307 in premium-paying mortgages have been insured, only $8,748 of net losses have been sustained.

V

The special terms applied to homes of $6,000 value or less are of little practical significance at present in our largest cities. They are small-community aids.

In the City of Chicago such homes, under present structural customs, can be erected, it is estimated, wherever fully improved lots are available under $1,000. This applies principally to about 21 suburban communities. Within the City possibly 10 sections would be eligible, ranging in distance from 7 to 14 miles from the central business section. Of these areas several are within such close proximity to industrial plants and railroad yards as to make living conditions quite undesirable. Some are at present zoned as industrial locations; but more of zoning later.

In addition, there are many areas of shifting population and depreciating property values which require special planning for rehabilitation. It is estimated by the Metropolitan Housing Council of Chicago that 280,000 persons have moved out of areas adjacent to the Loop, or central business district. Most of this property doubtless will surrender to business or light industrial use, or require multiple-dwelling construction of the apartment-house type.

Of greater advantage to housing in the large city are other features incorporated in the recent amendments.

On new single-dwelling, owner-occupied construction, appraised at not more than $10,000, the 90% insurance arrangement may apply to the first $6,000 and 80% to the balance. Since the owner would be obliged to provide down payments of $600 on the first $6,000 and $800 on the remaining $4,000, the maximum principal obligation subject to insurance is placed at $8,600.

Encouragement of large-scale construction of groups of houses and apartment dwellings is to be accomplished by blanket mortgages. Two categories are recognized.

Insurance to a maximum of 80% of appraised value is authorized for the construction of multi-family dwellings or for groups of not less than 10 single-family homes in which principal obligations amount to not less than $16,000 and not more than $200,000. The loans

are not to exceed an average of $1,150 per room. This limitation in cost per room is a substitute for the previous provision, difficult of interpretation, which attempted to encourage development of dwellings for "persons of low incomes." This category is designed to assist building concerns in the single-home or small-apartment field. It may be of interest, therefore, to mutual thrift and finance groups as well as to banks and insurance companies.

Another authorization is entitled "Rental Housing Insurance," and provides for large-unit projects in which the insured loans, at 80% of value, are not to exceed $5,000,000. These loans may be made to governmental institutions, and to private corporations, associations, cooperative groups, and trusts. These projects, not to exceed $1,350 per room in cost, are subject to approval by the government Administrator as to rents, charges, capital structure, rate of return, and methods of operation. The interest rate on the mortgage loan is not to exceed 5%. This category probably will appeal primarily to banks and insurance companies.

Although New York City, Indianapolis, Washington, D. C., and Clarendon, Virginia, have successfully built multiple-dwelling units under the limited-dividend company provisions of the National Housing Act, Chicago has just started its first project, one of five planned, which will involve together expenditures exceeding $6,000,000 and provide for 1,600 families. The mortgage of this first project will cover a period of 26 years; it bears an interest rate of 4½% and carries FHA insurance. The cost of this project is estimated at $1,000,000. The mortgage is for $750,000 and is the largest to be insured by the FHA in this section of the country. Fourteen separate buildings will contain a total of 196 apartments of four and five rooms. The development is located near the city boundary.

However, the rentals for this new project have not yet been announced. Perhaps the rentals may be inferred from those of the "model low-rent dwellings" of the Public Works Administration. This monthly rental scale is $24.50 to $29.00 for four rooms, and $28.50 to $33.50 for five rooms. Probably the new structures developed by private capital will charge still higher rents. But at current average earnings of employed male industrial workers, rentals should not exceed an average of $32.00.

While high rentals are an obstacle to occupancy in a period of low or fluctuating incomes, they are inducements to construction under more favorable circumstances. They are the income from capital investment. Consequently, movements in rentals are carefully observed by real estate developers, mortgage agencies, and large investors.

Current rentals in Chicago are about 7% above the average for 1936. The lowest recent point in the rental index was reached in the fall of 1934, approximately 8% below the average of 1936. The highest recent rentals in the fall of 1931 were 56% above the 1936 level.

In point of time, maximum rentals were reached five years subsequent to the year of greatest construction, and minimum rentals one year following the year of smallest construction. The low point of rentals also lagged approximately 1½ years behind the point of lowest earnings and of lowest construction costs. Comparing the amplitude of movement, between low and high points, rentals led with the greatest range, followed by earnings and by the per cent of occupancy. Only the occupancy rate has at present regained its former position.

Obviously, with an increase in population, additional housing is required to meet the needs of new families. As a general standard, a 4% excess of dwellings over family demands is regarded as normal. Under such a condition, the occupancy would be slightly more than 96% of available dwellings.

But with varying economic and social conditions the proportion of dwellings occupied fluctuates widely. Steady employment and increased income encourage families to increase expenditures for housing accommodations. If, in addition, there is a shortage of shelter during prosperity, the occupancy rate may reach 100% and an overflow occur with sharing or "doubling-up." But doubling-up occurs under the opposite condition, as well, in a period of hard times, with a low occupancy rate.

Practically all inhabitable dwellings in Chicago were occupied during most of the period, 1921–1923. Building restrictions of the war period had abetted the growing shortage, while low incomes of late 1920 and 1921 had necessitated city-wide sharing of homes.

The per cent of occupancy had risen sharply from about 84 in early 1919 to 100 in the fall of 1921. From 1924, with the building boom and improved business conditions, the percentage of dwellings in use declined steadily, but not precipitously, until 1929. Maximum new residential construction was reached in 1926. Following the crisis of 1930 the tendency to vacate accelerated; a low occupancy ratio of 75% was reached in 1933.

Within the next 15 months occupancy improved 20 points, to a height of 95% in July, 1934—a ratio last recorded in 1926. At present, it is approaching 99%. This is doubtless an indication of shortage, for a large amount of doubling-up from unemployment and inadequate income still remains.

VI

In public addresses the President has spoken boldly of the fact, generally recognized, that construction costs are a retarding factor in building activity. He has courageously included in his criticism the pegged labor rates in many communities and has urged the advantage of reduction in hourly charges as a means of producing work and, thereby, of increasing the aggregate of annual income. Of the many causal factors perhaps two are most significant: (1) the fixing of prices through agreement; and (2) the cumbersome structure of material distribution from manufacturer to builder. The former may require government action to eliminate restraint of trade. The latter may have to await the development of competition by factory-to-builder agencies following, in general, the mail order procedure; or the creation of a cooperative movement to eliminate the costs of the middle man.

The importance of the cost element is obvious. A home at $6,000 is meager indeed when the costs of materials and of labor are high. A house built in 1936 at $6,000 would have cost about $7,600 in 1923, $5,060 in 1933, and approximately $6,660 at present. The difference between the 1936 and the present cost is more than sufficient to care for the owner's equity of 10% required under the new legislation.

In our comparisons, construction costs should be related, as in the case of any other price relations, to purchasing power. A high cost in dollars is relatively low if earnings are still higher. High real income, then, is the chief determinant of an effective demand for housing. Had the present setback in business progress not occurred, it is probable that earnings, together with high ratio occupancy, would have spurred rents upward, resulting in building activity in the current

year despite rising costs of construction.

Construction costs reached a peak in 1923, then declined gradually until 1930. Building activity rose simultaneously with costs but continued to its maximum in 1926. The relationship, therefore, is not synchronously inverse.

The present situation, unless costs fall, suggests two movements: (1) increased activity in the marketing of dwellings already built, and their rehabilitation and modernization; and (2) innovations in the uses of materials and of the technique of construction.

The first will help many banks, insurance companies, mortgage-financing institutions, and others to unload property acquired by mortgage foreclosure. It is estimated that one-half billion dollars is frozen at present in residence properties (including multi-family dwellings) held by financial institutions in the Chicago Federal Home Loan Bank area.

In the second case, ingenuity may break the rigidity of prices and substitute machine for labor. Evidences of innovations of this type are appearing already in an effort to meet the $6,000 limit within large cities.

Both procedures will be constructive. The former will clear the books of property bought under distress conditions, and permit expansion into new financing. The latter should indirectly reduce the cost of construction by offering the competition of substitute housing. But, in the interval, the capital goods industry must await the slow economic process of adjustment, and cannot expect from an insurance feature alone a boom of such proportions as to accomplish a business revival of consequence immediately.

After the impetus is well under way, a lapse of 10 to 12 months must be expected before the construction is available for occupancy. The willingness of tenants and owners to obligate themselves is related to prospective income. The response of enterprise to the invitation to build will depend upon estimates of opportunity for profit; on the outlay side is the cost of construction, and on the income side the prospects of employment determining ability to pay rents and to liquidate mortgages.

Two related factors are particularly detrimental to Chicago's welfare: the real property tax situation, and the archaic zoning code. The former has been the basis of litigation, delinquency, foreclosure, and public concern for many years. The latter is so unrelated to modern needs and developments as to handicap Chicago as a business center and as a home. Many authorities associated with various fields of business and social interests place the responsibility upon the political machine of the City and of Cook County.

VII

Another amendment to the original FHA legislation further encourages the establishment of national mortgage associations. Such associations if controlled or operated by the United States may not make loans upon the usual one- to four-family groups, but only on larger unit projects. If organized by private capital, loans may be extended if accepted for insurance by the FHA. These private mortgage associations are given power to purchase, service, and sell any mortgage insured under Title II (loans for purchase, refinancing, or construction) and, in addition, to market uninsured first mortgages. But uninsured mortgages may not exceed 60% of the appraised value of the property.

Each national mortgage association must have a minimum capital stock of two million dollars, but may operate when 25% has been paid in cash, govern-

ment securities, or eligible first mortgages.

National mortgage associations may issue notes, bonds, or debentures up to 20 times the paid-in capital and surplus, but not in excess of its Title II mortgages plus cash and government bonds.

From the point of view of business operation a capital margin of 5% appears quite inadequate. If securities are issued, the private investor will expect an adequate return, and the profits will depend upon the success of a national institution in competing with local, established firms for its mortgage business.

Further to promote national mortgage associations, statutes governing national banks are amended to permit them to invest in obligations or securities of these mortgage institutions.

VIII

The assets and liabilities of the housing legislation may be summarized as follows:

Encouragement has been given private capital to enter the mortgage-investment field at once, with a guarantee against loss; the device is an insurance fund controlled by the Federal Government. Recent amendments particularly aid banks and insurance companies to release their large idle funds.

National mortgage associations may operate to a degree as does the Federal Reserve Bank in the commercial banking field. This innovation may extend the market as the monetary system is extended by the limited reserve base.

Emphasis has been placed upon the need for more adequate, healthful living accommodations for our people, through slum clearance, renovation, garden developments, single- and multiple-dwelling construction at a cost within reach of the low- and middle-income groups.

Attention has been focused upon costs not alone by direct attack upon price agreement but, in addition, by establishing maximum interest and insurance rates in the financing undertaken under government supervision. However, previously the uncontrolled rates had been a small factor in retarding building, as compared with the pyramid of other costs involved.

The amount of equity required has been greatly reduced by permitting insurance of 80 and 90% of the appraised value upon which the loan is based. This limiting of the down payment required has resulted in the extension of the period of the contract as the necessary alternative to increased monthly payments.

Ninety per cent insured mortgages will be of principal value in smaller cities or rural communities, since $6,000 is not an adequate amount for construction of a modern home in most large cities. However, this limit may encourage a revolution in construction methods and materials.

Basically, demand for housing depends upon real income, and until earnings increase or prices decrease a large volume is not to be expected. Construction will be an aid to prosperity just as soon as these adjustments of purchasing power occur.

Though many of the provisions of the new legislation may not prove effective, the impetus to public interest and to private action may exceed all current estimates. It is not improbable that future development of housing in the United States will trace its origin to the model house that Franklin built.

A Regulatory Dilemma:
Limited-Term Franchises, Municipal Competition and Ouster Proceedings

By D. L. MARLETT*

TWO cases which may be of nationwide significance for the problem of municipal competition with privately owned electric utility systems are now before the Illinois Commerce Commission for decision.[1] Broadly speaking, the principal question presented is the right of a municipality to oust a private electric utility upon expiration of the latter's limited-term franchise and upon establishment of a municipal plant by the city. In the determination of this broad question, however, a number of specific issues arise. The two cases present substantially the same issues, which, together with the circumstances leading to their filing, can best be described by reference to the proceeding filed by the City of Geneseo.

Statement of Facts[2]

Both parties to the Geneseo case readily agreed to all the important facts. The issues rest largely upon conclusions drawn from the facts, application of the law to them, or formulation of regulatory policy.

The City of Geneseo, an incorporated town of 3,400 population, granted a 10-year, electric-service franchise on June 18, 1923 to Illinois Northern Utilities Company, which is part of the Commonwealth Edison Company system and which serves 170 urban and rural communities located in 17 counties in northern Illinois. The company, which also holds a certificate of convenience and necessity granted by the Illinois Commerce Commission,[3] has only distribution facilities in Geneseo, to which it transmits energy generated elsewhere in the system. The municipal franchise was granted two years after the Illinois Municipal Ownership Act had been amended in 1921 to authorize municipalities to acquire, own, operate, and regulate their own public utilities without being subject to state commission

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[1] *City of Geneseo v. Illinois Northern Utilities Co.*, Ill. C.C. Docket No. 26345, and *Village of Heyworth v. Central Illinois Electric & Gas Co.*, Ill. C.C. Docket No. 26346.

[2] See Briefs of Complainants and Respondents in Ill. C.C. Docket No. 26345.

[3] Section 55 of the Illinois Public Utilities Act, governing the granting of a certificate of convenience and necessity by the Commission reads as follows:

"No public utility shall begin the construction of any new plant, equipment, property or facility which is not in substitution of any existing plant, equipment, property or facility or in extension thereof or in addition thereto, unless and until it shall have obtained from the commission a certificate that public convenience and necessity require such construction.

"No public utility not owning any city or village franchise nor engaged in performing any public service or in furnishing any product or commodity within this State and not possessing a certificate of public convenience and necessity from the State Public Utilities Commission or the Public Utilities Commission, at the time this Act goes into effect shall transact any business in this State until it shall have obtained a certificate from the commission that public convenience and necessity require the transaction of such business.

"Whenever after a hearing the commission determines that any new construction or the transaction of any business by a public utility will promote the public convenience and is necessary thereto it shall have the power to issue certificates of public convenience and necessity.

"Such certificates may be altered or modified by the commission, upon its own motion or upon application by the person or corporation affected. Unless exercised within a period of two years from the grant thereof authority conferred by a certificate of convenience and necessity issued by the commission shall be null and void.

"No certificate of public convenience and necessity shall be construed as granting a monopoly or an exclusive privilege, immunity or franchise."

regulation, and without being specifically required to purchase the facilities of the private company.

Upon expiration of Illinois Northern Utilities Company's franchise on July 12, 1933, the city notified the company that no renewal would be granted and that the option, provided in the franchise, to purchase the electric company's facilities would not be exercised. The city had proceeded to construct a municipal plant with funds obtained primarily by sale of its bonds, and on September 12, 1933, two months after expiration of the electric company's franchise, the city council adopted an ordinance ordering the private company to vacate the city within 90 days. The company refused to obey this ordinance, but instead filed with the Illinois Commerce Commission temporary competitive rates for the City of Geneseo, which were lower than the municipal plant's rates. The Commission permanently suspended the rates filed by the company and directed the filing of temporary optional rates identical with those charged by the municipal plant.[4] Obviously, this situation resulted in duplicate distribution facilities and competition between the municipal plant and the privately owned company. At the present time the municipal plant serves roughly ⅔ of the total customers and supplies about 80% of the total current sold in the city.

Following the refusal of the company to comply with the city ordinance of September 12, 1933, the city, pursuant to an ordinance of December 20, 1933, filed a complaint against the company in the County Circuit Court for a mandatory injunction directing the company to vacate the city, on the ground that the company has no right or authority for continuing to be there. In its answer to this complaint the company stated that it is a public utility within the jurisdiction of the Illinois Commerce Commission; that the Public Utilities Act prohibits abandonment of service and removal of facilities without consent of the Commerce Commission; and that the city is without authority to order the removal or to maintain the suit. The city made a motion to strike this answer on grounds of insufficiency, which motion was allowed. After referring the case to a special master the trial court entered a decree granting the mandatory injunction as prayed by the city. The company appealed the case to the Supreme Court of Illinois, which ruled that the city was without legal power and authority to maintain the proceeding, reversed the trial court, and remanded the cause to the trial court with directions to overrule the city's motion to strike the company's answer.[5] The trial court complied with this mandate and on motion by the company dismissed the city's suit. The result of this legal battle obviously was to leave the situation substantially as it was: duplicate distribution facilities, competition between the municipal plant and the private company, and continued refusal of the company to comply with the city's order to vacate.

In the Illinois Supreme Court's decision the court ruled in substance that the power to determine whether the company shall continue or cease its utility business in the city rests with the Illinois Commerce Commission, in which body the State has vested sole super-

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[4] *In the matter of the Illinois Northern Utilities Co.*, Ill. C.C. Docket No. 22736, March 30, 1934. This provision is still in effect although, of course, rate changes by both the municipal plant and the company have been made since the 1934 order.

[5] *City of Geneseo v. Illinois Northern Utilities Co.*, 363 Ill. 89 (1936). This case was reviewed in 12 *Journal of Land & Public Utility Economics* 433 (November, 1936). Also see 31 *Illinois Law Review* 122 (1936).

vision of privately owned public utilities and, for public utility purposes, title to public places of the city.[6] Pursuant to this decision and the authority of an ordinance of June 8, 1937, the city filed its complaint before the Illinois Commerce Commission, praying that the Commission order the company to vacate the city. The case was heard in January and February, 1938, briefs were filed in April and May, oral argument was heard on May 25, 1938, and the case has been taken under advisement by the Commission.

While these maneuvers of the private company and the municipality were occurring, the Public Utilities Act was amended in 1935 by the addition, among other provisions, of a section which states that no public utility shall abandon or discontinue any service without first having obtained the approval of the Commission, which approval may be conditioned by the Commission.[7] As far as the writer has been able to ascertain, this provision was apparently recommended by members of the Commission's staff and added to the law without any thought of its bearing upon the City of Geneseo case, which at that time was in the courts. No specific reference to this provision is found in the decision of the Illinois Supreme Court in the Geneseo case, which was handed down on February 14, 1936. In other words, the Illinois Supreme Court decision, holding that the power to determine whether a private utility shall continue or cease its utility business in a municipality rests with the Commission, seems to have been based upon the court's interpretation of general provisions of the Public Utilities Act, and not upon the new provision added to that act in 1935.

The Issues

It is now in order to set forth the issues, which, though they may appear simple at first blush, in reality involve a number of complications.

1. Probably the first major question to decide is whether the complainant municipality is appearing before the Commission in a proprietary or in a governmental capacity. The company claims that the power to determine whether service of a public utility shall be discontinued has been removed from the city and vested in the Commission; that the city is acting in a proprietary capacity as the owner and operator of an electric public utility system; that the only legitimate way the city can obtain a monopoly or exclusive franchise of the electric business is by acquiring the facilities of the private company by purchase or by condemnation; and that the city is

[6] In answer to the city's claim that, with the expiration of the franchise contract, the company is estopped from denying the title of the city to the streets and its right to remove the company's property therefrom, the Illinois Supreme Court said:
"The power to determine whether the defendant shall continue or cease its utility business in the city rests with the commission. The situation presented is not that of landlord and tenant or a like relation. The title which the plaintiff originally had in the premises was merely at the sufferance of the true owner, the State. The State has, for public utility purposes, withdrawn that title from the plaintiff and placed it in the commission; neither party to the contract can impinge upon the powers of the commission and the doctrine of estoppel is not invokable nor applicable."

[7] Illinois Laws 1935, p. 1103, §49a. This section reads as follows:
"No public utility shall abandon or discontinue any service without first having secured the approval of the commission. In granting its approval, the commission may impose such terms, conditions or requirements as in its judgment are necessary to protect the public interest. Provided, however, that any public utility abandoning or discontinuing service in pursuance of authority granted by the commission shall be deemed to have waived any and all objections to the terms, conditions or requirements imposed by the commission in that regard. Provided further, that nothing in this section shall be construed to limit the right of a public utility to discontinue service to individual patrons in accordance with the effective rules, regulations, and practices of such public utility."

attempting to use unrelated governmental powers to oust the private company and thereby obtain a monopoly to which it is not entitled as a matter of law. The city answers that it comes not as a competitor but as a local sovereign attempting to exercise its legislative power to control the *right of occupation* of its streets, as distinct from exercise of the police power to regulate *use* of the streets, and that in any event the city is not specifically *required* to acquire by purchase or condemnation the facilities of the private company at the expiration of its franchise in order to obtain a monopoly of the electric business, but is merely given the *power* and *permission* to do so, with an option to refuse to purchase or condemn and to construct its own system.

Assuming City in Proprietary Capacity

2. The decision on the above described issue may determine the direction which the remainder of the decision will take. If the municipality is appearing as an ordinary competitor, does it have a sufficient interest to maintain the complaint? If the city cannot maintain the complaint, what is its recourse? The courts have refused to enforce the city's ouster ordinance on the grounds that the power to order discontinuance of service is vested in the Commission, but if the jurisdiction of the Commission cannot be invoked, the city would seem to have no place to turn—unless to the legislature.

3. On the other hand, if the complaint can be maintained by the city, is an ordinary competitor immune from competition? The answer to this last question depends upon whether the competition is lawful. The lawfulness of the competition upon the part of the municipality depends largely upon interpretation of the Illinois Municipal Ownership Act, but there would seem to be little ground for challenging the right of the city, under that act and other provisions of law, to enter the electric utility business as it has in this case. On the other side, if a private company holds a certificate of convenience and necessity from the Commission but has been ordered by the municipality to vacate upon expiration of its franchise, is such a company engaging in lawful or unlawful competition with the municipal plant? If such competition is lawful, the municipality would hardly be immune from such competition, but if it is unlawful the municipality would seem to have good grounds for its complaint. Assuming the municipality is appearing as an ordinary competitor, this is an important and difficult issue to decide—one on which there do not appear to be any previous significant and clear-cut decisions, under circumstances like these in Illinois.

Assuming City in Governmental Capacity

If it is decided that the municipality is appearing in a governmental capacity, the question whether the city has sufficient interest to invoke the Commission's jurisdiction could still be raised, although seemingly with less force. In general, however, with the city appearing in a governmental capacity, somewhat different issues are presented. The fact that the municipality is engaged in the electric business as a competitor with the private company would seem to have but little direct bearing upon the problem. The general question presented is whether the Commission is required by law or should in its discretion order the public utility to vacate the city in conformity with the city ordinance.

4. The municipality contends that it is the duty of the Commission, under the facts of this case, to rescind its certificate of convenience and necessity and

to order the utility to obey the city ordinance. According to this position the sole intent of the Illinois Supreme Court in the Geneseo case was to require application to the Commission as a matter of procedure, but not to give the Commission any discretion to decide the contentions of the respective parties. The basis for this position is the statutory duty of the Commission to see that "the provisions of the Constitution and statutes of this State affecting public utilities . . . are enforced and obeyed. . . . "[8] In reality this contention involves three different issues, as outlined below.

4a. Does a city ordinance come within the meaning of the term "statute" as used in the above quotation?[9] If not, then the basis of this contention collapses, for the fundamental proposition is that the city ordinance is the law governing occupation of the streets of the municipality and that it is the duty of the Commission to require the company to obey this law. If this question is decided against the city, then the Commission is in effect holding that it may exercise its discretion in deciding the question of discontinuance of service.

4b. Questions also arise in the interpretation of the Illinois Supreme Court's decision in the Geneseo case. What did the court mean when it said: "The power to determine whether the defendant shall continue or cease its utility business in the city rests with the Commission?" The city contends that this power is one which *must* be exercised to order the company to vacate the city because of the municipal ordinance; that the decision merely requires the municipality to apply to the Commission rather than to exercise this power itself; and that the Commission has no choice in the matter. The company answers that the court in the Geneseo case decided that whether service should be discontinued presents an administrative question for determination by the Commission in the exercise of its discretion on the basis of public interest. It is unfortunate that the Illinois Supreme Court did not clearly dispose of this issue by setting forth the basis for a Commission decision in a case of this nature; the court did not even refer to a specific provision of the Public Utilities Act to guide the Commission, but merely stated that the Commission has the *power*.[10] If the Commission follows the contention of the company, the question of discontinuance of service will be decided by exercise of the Commission's discretion on the basis of public interest.

4c. On the other hand, if the Commission decides that the Illinois Supreme

[8] Illinois Public Utilities Act, §79, which reads in full as follows:

"It is hereby made the duty of the commission to see that the provisions of the Constitution and statutes of this State affecting public utilities, the enforcement of which is not specifically vested in some other officer or tribunal, are enforced and obeyed, and that violations thereof are promptly prosecuted and penalties due the State therefor recovered and collected, and to this end it may sue in the name of the People of the State."

Other sections of the Act of somewhat similar import are also relied upon. Section 8 reads in part as follows:

"The commission shall have general supervision of all public utilities, except as otherwise provided in this Act, shall inquire into the management of the business thereof and shall keep itself informed as to the manner and method in which the business is conducted. It *shall examine* such public utilities and *keep informed* as to their general condition, their franchises, capitalization, rates and other charges, and the manner in which their plants, equipment and other property owned, leased, controlled or operated are managed, conducted and operated, not only with respect to the adequacy, security and accommodation afforded by their service but also *with respect to their compliance with the provisions of this Act and any other law, with the orders of the commission and with the charter and franchise requirements.*" (Italics supplied.)

Also see §§60, 64, 65, 75.

[9] Or the term "law" in Section 8, quoted in footnote 8.

[10] Of course, it should be remembered that the court's whole discussion was on the procedural question whether the city could maintain the action.

Court in its decision did not intend to give the Commission any discretion in the matter, then a further question arises—namely, are circumstances altered by the addition to the law in 1935 of Section 49a, prohibiting a public utility from abandoning or discontinuing service without first having obtained the approval of the Commission, which approval may be conditioned?[11] The court apparently gave no consideration to this new provision, but the city contends that the situation is in no way altered by the provision. The grounds for this contention are: (1) that an amendment to the Cities and Villages Act passed in 1935 after Section 49a was added to the Public Utilities Act, reveals the legislative intent of leaving control over occupation of streets by public utilities with permanent fixtures in the city[12] and therefore that Section 49a should not be interpreted to divest the city of this control; and (2) that, if the provision is interpreted to grant the Commission any discretion in the case, it becomes unconstitutional as an improper delegation of legislative authority. The city's argument is that this new provision has no application to this case but merely imposes a burden on a public utility by way of limitation, and means that a private utility will no longer be allowed to run out of its own volition without regard to the public interest.

The company contends that the legislative intent was to vest in the Commission discretionary power over all abandonments of service, including that requested by the city in this case, and that the new provision is not an improper delegation of legislative power because, by permitting the Commission in approving the abandonment or discontinuance of any service to impose such conditions as are necessary to protect the public interest, it sets up a definite administrative criterion in the term "public interest."

If, after considering the above questions, the Commission decides it can exercise its discretion in deciding this case, the issue will turn upon proof of public interest. The questions here presented are: (1) upon whom does the burden of proof rest; (2) what must be proved; and (3) what is the weight of the evidence?

5. With the municipality appearing in a governmental capacity, does the burden of proof of public interest rest upon it or upon the company? Ordinarily the burden of proof rests upon the complainant, which in this case is the municipality, and no special grounds for a contrary rule appear to have been urged upon the Commission in this case. Whoever has the burden of proof must affirmatively show that the public interest requires removal or retention of the facilities of the private company.

6. What must be proved? The city claims that in view of the ouster ordinance, the Commission is bound to order the removal *unless* the public interest will be injured thereby (as in the absence of any other available source of similar service); that the interest involved is the interest of the general pub-

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[11] See footnote 7 above.

[12] The amendment was to Section 34 of Article XIII of the Cities and Villages Act (Laws 1935, p. 372), which governs the procedure of cities for lawful granting of "any franchise, right or license to occupy or use the streets, alleys, highways . . . or public places" for public utility facilities. The city also claims this amendment repudiates any application of the Chicago Motor Coach case to permanent utility fixtures as distinct from the transient use of streets by motor busses. In *Chicago Motor Coach Co. v. City of Chicago* (337 Ill. 200 (1929)) the Illinois Supreme Court expressly held that the provisions of the Utilities Act withdrew from municipalities the power which they had previously exercised in relation to use of the streets, alleys, and public places by public utilities and that these powers were conferred upon the Commission.

lic in Geneseo; and that with a showing that the city is prepared to furnish adequate and satisfactory service to the public upon the withdrawal of the public utility, public convenience and necessity do not require continued existence of the private utility; and that in fact its continued existence would only result in ruinous competition, which it is the policy of the Public Utilities Act to prevent. The company, on the other hand, claims that the Commission is directed to promote and protect the public interest and that the public interest involved is the interest and welfare represented by the availability of adequate and efficient service at fair and reasonable rates throughout the entire territory, including the City of Geneseo, served by it.

The differences in these positions are readily apparent. In the first place, according to the city it need only be shown that public interest will not be injured, while according to the company it must be shown that public interest will be promoted and protected by the removal or retention of the facilities. In the second place, the public interest according to the city is the interest of the general public in Geneseo, while according to the company it is the interest of the public in its system-wide territory as well as the interest of the local public in Geneseo.

7. The evidence presented by the city was confined to a showing that the municipal plant is now serving ⅔ of the customers in the city; that it is adequate to serve the remaining customers of the private company in Geneseo; that a city ordinance has been adopted providing for a reduction in rates to become effective upon removal of the private company from the city; that the financial condition of the municipal plant is good; and that net additional profits would accrue to the city plant if it were to acquire all the business, thereby making possible further rate reductions as well as a stronger financial condition. The company presented evidence indicating that it is rendering adequate and efficient service throughout its territory —including ⅓ of the customers in Geneseo—at presumably fair and reasonable rates; that it would suffer a capital loss of $19,330 in removing its facilities and an annual operating loss of $8,879; that it would be required to make an additional investment of $5,700 to serve 81 rural customers outside Geneseo; that the facilities in Geneseo are a part of a larger electric utility system. If the proof must show merely that the public interest will not be injured, as claimed by the city, has the burden of proof been sustained to justify removal or retention of the private company? Or, if the proof must show that the public interest will be promoted and protected, as claimed by the company, has the burden of proof been sustained to justify the removal or retention?

The above appear to be the principal issues of the Geneseo case, but two other general questions may be mentioned. First, has the Commission power to revoke a certificate of convenience and necessity once granted? In view of the Geneseo case ruling by the Illinois Supreme Court, as well as the provisions of the Public Utilities Act,[13] no adequate grounds appear for questioning this power, although technical questions have been raised as to whether the power can be exercised on the basis of the filed complaint and the facts of the case. Second, the company has raised the point that its property would be confiscated if it were ordered to vacate the city, but the city answers that in view of the expiration of the franchise privi-

[13] See footnotes 3, 6 and 7 above.

lege, or property right, to conduct business in the city, and in view of the fact that the city is not attempting to appropriate the physical property, no confiscation can exist. The real issue here is whether an order to vacate would have adequate foundation, and that involves the questions already discussed.

The Implications

The Commission appears to be confronted with the two horns of a dilemma. If it dismisses the case for want of jurisdiction, or if it denies the prayer of the city to order the company to vacate and this denial is sustained in the courts, then for all practical purposes the effect would be to nullify the city's control over occupation of its streets except for initial permission, to uphold public utilities in ignoring their franchise contracts in so far as limited-term provisions are concerned, and perhaps to retard development of municipal ownership by permitting public utilities to compete with municipal plants even after expiration of their franchises.

On the other hand, if the Commission grants the prayer of the complaint and orders the utility to vacate, then for all practical purposes the effect would be to invite all utility companies to apply for rates which would permit them to amortize their investments over the life of their municipal franchises, on the ground that they might be ordered to vacate at the end of their franchise terms. The city recognizes this point in its brief when it says:[14]

> "How much sympathy can one have for enfranchisees who, with the knowledge that they had only a limited period of time within which to conduct their business, so recklessly invested sums which they could not hope to regain within that period? Entering the city under permits which they knew would expire, which they had no reason to believe would be renewed, and which prior to the Geneseo decision no one had ever considered as having an indeterminate character, they should have amortized their investments over the periods of their franchises and should not have permitted themselves to get in a position from which they could not extricate themselves without loss."

Of course, public utilities would doubtless think twice before pursuing such a course, for it merely invites municipal ownership; but one can readily imagine the extent to which public utility regulation might be undermined and municipal ownership promoted, if a precedent is established for ordering utilities to give up their business without any compensation whatever upon expiration of their franchises.

The problem is not an easy one to solve under the prevailing legislative acts and court decisions in Illinois. Any fair-minded person would doubtless agree that it is desirable for municipalities to have the largest possible measure of control over occupation of their streets, to expect performance on their contracts, and to be able to enter the electric business if it is the will of their citizens. But likewise any fair-minded person would doubtless agree that it is neither economical nor desirable to expect or even require a privately owned utility to make costly investments necessary to serve a municipality only to be ordered to vacate without any compensation upon expiration of a limited-term franchise. Perhaps the ultimate answer must be provided by the Legislature in the form of compulsory purchase or condemnation provisions in the municipal ownership law, or an indeterminate permit law such as prevails in Wisconsin. Nevertheless, it will be interesting to see how the Commission disposes of this immediate problem.

[14] At pp. 22–3 of Reply Brief of Complainants.

Land Reserves for American Cities

By HAROLD S. BUTTENHEIM* *and* PHILIP H. CORNICK†

INCREASED public ownership of urban and suburban land would make possible more adequate planning and zoning control on such land than experience has shown to be generally attainable under prevailing conditions. Communities would have land available for low-rent housing, recreational areas, allotment gardens, town forests, parking spaces, public buildings, and other municipal improvements. If acquired at reasonable prices, publicly owned land would conserve for the public some of the land-value increments which will result from future population increases and public expenditures. A pool of public land, available for lease for private use, would help to combat land gambling and to minimize cyclical extremes in building activities by leveling off the peaks and filling in the valleys.

In all urban and suburban areas throughout the United States there is much vacant land which might be used in the public interest. Many American municipalities might add appreciably to their land holdings at small cost by taking advantage of opportunities to acquire title to tax-delinquent land. Since such land is only nominally on a tax-paying basis, there would be little or no loss in revenue to the city. Unemployed land, like unemployed men, is an economic and social drag on the community.[1]

Municipal Land Ownership in Europe

While American cities have as yet done little to add to their land holdings for other than immediate public needs, the experience of numerous European cities has demonstrated the wisdom of public land reserves. Acquisition of public land for housing purposes is reported from cities in Austria, Czechoslovakia, Finland, France, Germany, Great Britain, Holland, Italy, Norway, Poland, Spain, Sweden, and Switzerland. Russia is, of course, the outstanding example of public land ownership, but more years must elapse before the Russian experiment can be properly evaluated.

Many municipalities in Scandinavian and Germanic countries have long held considerable amounts of land, some of it handed down from mediaeval times. In some countries this has been augmented by large grants from forests and estates of the national domain. In Finland, for instance, the State, up until the nineteenth century, gave land for founding towns, usually on condition that the full property rights should not be given to private individuals. Although this provison was modified late in the nineteenth century, towns still own practically all land within their boundaries. By 1926, the total area of building sites sold by all Finnish municipalities amounted to

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[1] This summary of the case for municipal land reserves is based on a report on "Increased Public Ownership of Urban and Suburban Land," submitted to the American City Planning Institute and published in *The Planners' Journal* for July-August, 1937. Source material for the rest of the paper has come largely from the as-yet unpublished report to the National Resources Committee of its sub-committee on "Land Policies for Rational Urban Development," and from the report on "Premature Subdivision and Its Consequences," recently published by the New York State Planning Council. The present paper was submitted by the authors, as a committee of two on Urban Land Policies, at the National Conference on Planning, held at Minneapolis, June 20–22, 1938, the proceedings of which will be published by the American Society of Planning Officials and the American Planning and Civic Association.

only 3.5% of the combined areas of all the towns. Helsingfors with an area of 6,300 owns 13,000 acres of land, much of it outside the city limits.

From the end of the nineteenth century municipalities in Finland, Norway, Sweden, Denmark, the Netherlands, Germany, and Austria have pursued a systematic policy of steadily increasing their land holdings both within and outside the city limits. Since 1904, the land acquisitions of Stockholm, mainly for housing purposes, have amounted to over 20,000 acres, or five times the area of the original City. The five next largest Swedish cities own from 47 to 80% of their administrative areas (Fefle, 80%; Norrkoping, 75%; Malmo, 49%; Helsingburg, 49%; and Gothenberg, 47%). Copenhagen owns over 1/3 of the total area within its limits available for building. Oslo owns a suburb that is twice the area of the City. The Hague holds title to 4,408 acres, or 45% of the city area. Zurich owns 5,621 acres, 1/2 of which is within the City.

Vienna owns more than 15,000 acres, exclusive of streets, or more than 1/4 of its area. Exclusive of streets and railways, Berlin has a municipal domain of over 75,000 acres within its limits, embracing more than 1/3 of its area, and owns another 75,000 acres of forest and agricultural land outside the city proper. Most German cities own considerable tracts outside their limits, frequently larger than their holdings in the city proper. An outstanding example is Goerhitz, with an administrative territory of 7,546 acres and 72,430 acres of forest land. In addition to land for public buildings, parks, and other uses common in American cities, German municipalities own extensive forests and agricultural estates managed either by the city or leased to private operators. In many cities, particularly since the war, much housing has been built on land leased or sold from the public domain.

All German cities over 50,000 in population own, on an average, 23.6% of their municipal territory, excluding streets, railways, and land used for sewage disposal and similar services. The average distribution by specified uses of this 23.6% of urban land in 1933–34 was:[2]

Use	*Per Cent*
Forests	39.9%
Agriculture	39.9
Vacant property	5.6
Parks and gardens	4.8
Buildings	4.6
Miscellaneous	5.2
	100.0%

In European cities public land ownership has resulted in considerably lower land costs for a variety of projects. In the case of Wythenshawe, the City of Manchester, England, acquired 3,710 out of the 5,567 acres at agricultural value before any building was started. The estimated saving of some $5,000,000 will result in considerably lower rents or smaller public subsidy. In Stockholm the City was able to counteract threatened inflation of land prices. In Copenhagen, land speculation was effectively controlled during and after the war by the municipality's selling its own land at low prices and also by extending other government aid to housing conditional on low land prices.

Greenbelts and Green Wedges

It is no new idea that city expansion should be definitely limited by a surrounding greenbelt. Even as early as the reign of Queen Elizabeth, a proclamation was issued (in 1580) commanding "all manner of persons, of what qualities soever they be, to desist and forbeare

[2] *Statistisches Jahrbuch Deutscher Gemeinden*, 1935, p. 31.

from any newe buyldings of any house or tenement, within three miles from any of the gates of the sayd Citie of London, to serve for habitation or lodging for any person, where no former house hath bene knowen to have bene, in the memorie of such as are now living."[3] Although numerous attempts were made to enforce this and similar subsequent proclamations, the present size of London shows that Queen Elizabeth's "green girdle" was not effective. The idea, however, was never completely rejected and today is being supported, in theory at least, by many town planners and students of urban problems throughout the world—London included.

The folly of allowing further unrestricted expansion and disorderly sprawling of cities into rural areas, turning green fields and forests into dreary city streets and making the countryside inaccessible to the poorer inhabitants of the interior districts, is gaining increasing recognition both in America and Europe. The greenbelt idea rests on the proposition that solidly built up cities can be too large, that definite limits of expansion must be assigned, and that further growth in the region must take place in outer satellite communities separated from the central city and from each other by wide green spaces. This method of city growth is to be effected by the acquisition of a wide band of unbuilt land surrounding the city from which close building development is permanently banned. All communities that threaten to become too large should be thus "corsetted" by open fields, much as mediaeval fortifications kept towns from sprawling into the surrounding countryside.

A greenbelt not only limits the size of a community to a desirable maximum, but protects it from inharmonious encroachments. The greenbelt also provides much-needed breathing space to congested urban areas—a place where the smoke, dirt, and grime of the city are dissipated and the oxygen content of the air renewed. In the greenbelt might be located playing fields, golf courses, lakes for boating and swimming, allotment gardens, larger farms, meadows, and forests. The beauties and advantages of the countryside would be preserved on the very doorstep of the city.

Either in combination with greenbelts or alone, consideration should be given to the establishment of green wedges that would be gradually driven in farther and farther toward the heart of the city by acquiring land at their points. Such wedges would not only provide breathing space and recreational areas, but would serve as corridors leading out to the open country and as barriers between different parts of the city. The municipal forests that reach right into the heart of such German cities as Hanover, and many of the parkway developments in this country, such as the Westchester County Parkways in New York or Rock Creek Park in Washington, D. C., are good examples of green wedges.

Greenbelts are an integral part of the English garden cities, Letchworth and Welwyn, and of the new "greenbelt towns" of the Resettlement Administration in this country. Partial greenbelts or agricultural belts are found in many other planned developments in Europe. One of the most ambitious greenbelts ever undertaken is being planned to surround London. Land is now being gradually acquired by the many local authorities concerned, aided by the London County Council's offer to contribute

[3] London County Council, "Positive Planning in Great Britain," in Part 1, *Papers and General Reports*, International Housing and Town Planning Congress, London, 1935, p. 130.

£2,000,000 toward the cost. When completed, the greenbelt will not be continuous, because of intervening urban development, but will constitute a series of large permanent open spaces roughly forming a ring around the metropolis.

The 10-year plan for the development of Moscow provides for a combination of greenbelt and green wedges. The boulevards radiating from the heart of the City are being planned as parkways, broadening as they approach the immense circular belt of forest and park land which is being developed beyond the city limits. The banks of the Moscow River and the numerous canals and lakes are also being developed as parkways upon which a great deal of the City's new housing will front.

Former Land Reserves among Old American Cities

Land reserves, similar to those which European cities still maintain, were by no means uncommon in the early history of the older American cities on both the Atlantic and the Pacific seaboards. The English, Dutch, French, and Spanish laws of the period during which the early American settlements were established were of the type under which the foundations for many of the municipal land reserves in Europe were laid.

The charter granted in 1686 by Thomas Dongan, Lieutenant Governor of the then Province of New York and its dependencies in America, to the City of New York, "an ancient city within the said province," contained the following clause:

"3. And I do by these presents give and grant unto the said mayor, alderman and commonalty of the said city of New York, all the waste, vacant, unpatented and unappropriated lands lying and being within the said city of New York and on Manhattan's Island aforesaid, extending and reaching to the low water mark in, by and through all parts of the said city of New York, together with all rivers, rivulets, coves, creeks, ponds, waters and water-courses in the said city and island, or either of them, not heretofore given or granted by any of the former governors, lieutenants or commanders in chief under their or some of their hands and seals or seals of the province, or by some of the former mayors or deputy mayors and aldermen of the said city of New York, to some respective person or persons. . . ."

The Montgomerie charter of 1730, after confirming the earlier grant of uplands, extended it to include certain lands lying in the Hudson and East Rivers for a distance of 400 feet beyond low water mark. Much of the upland real estate was sold off during the succeeding 125 years to provide funds for capital improvements, for retirement of onerous debts, and even for current expenses; but as late as 1850 the residue is reported to have produced a revenue for the City of about $100,000 yearly. Until 1870, the City showed a similar tendency to alienate also its property beyond low water mark, but subsequently reversed its policy and began to develop a municipally owned dock system. Today, the City's gross rental from that source amounts to approximately $6,000,000 yearly.[4]

Similarly, New Orleans has held title since colonial times to lands under water along the Mississippi River, and during the present century has undertaken their development for a publicly owned dock and terminal system. Boston acquired large areas within its limits not by grant but by purchase, the famous Boston Common being a part of the remnant. In Massachusetts, Salem also held common lands during the same period, and still holds some of them. San Diego, California, until after the American occupation, owned common lands which

[4] *Annual Report*, Comptroller of the City of New York for 1937, p. 21.

had been granted to it during the days of Spanish rule. More extensive search would no doubt make it possible to expand the list of American cities which formerly owned much of the land within their limits.

No study seems to have been made which would explain why European cities have maintained their public domain intact and even expanded it during the period in which American cities dissipated their holdings. Except for the lands protected by dedication to public uses, such as streets and parks, the uplands formerly held by American cities seem to have been alienated almost in their entirety. On the other hand, considerable portions of the holdings of submerged lands suitable for development with docks and wharves have been maintained. Notable expansions in the land holdings of American urban municipalities outside of streets and parks seem to have been confined to the outlying lands essential for the protection of municipal water supplies. In some of the northeastern states, where farm abandonment has concentrated public attention on problems of reforestation, a considerable number of rural municipalities have made progress toward the acquisition and development of municipally owned forests.

It goes without saying that these long-run trends in our older and larger cities, coupled with the newer trends in some of our outlying rural municipalities, cannot safely be ignored in any consideration of the factors which must govern the formulation of a workable program for public acquisition and administration of municipal land reserves in the future.

Means for Acquiring Land Reserves

On the basis of the experience of European cities with extensive land holdings available for general purposes, and of a small handful of American cities with lands suitable only for specialized purposes such as docks, a strong case can be made for acquisition by the municipalities in this country of land reserves suitable for other than street and park purposes. One large question remains to be answered: How can such lands be acquired?

The means by which European cities acquired the nuclei of their present holdings, and by which the cities of colonial America acquired most of the holdings which they have since dissipated almost in their entirety, must be dismissed from consideration at the outset. The federal and state governments have no holdings of urban lands which could be granted to the cities. That fact at once removes the possibility of building up future municipal land reserves in this country from the chief sources of such reserves in the past.

Proposals have been recently made that the Federal Government should give grants-in-aid to municipalities to purchase land for housing purposes. A report by Frederic A. Delano, as Chairman of the Central Housing Committee, published in *The American City* for January, 1937, includes the following passages:

"The Federal Government gave our railways land in exchange for their services in spreading our population over the continent, and granted homesteads to any who would undertake to develop them. It would be only reasonable for the Federal Government to assist local governments to purchase land for two purposes: first, to help municipalities provide low-rent housing for families unable to afford shelter of minimum standards, and second, to stabilize the value of low-cost residential neighborhoods whenever protection by zoning regulations is incomplete, thus promoting simultaneously the home-building industry and sound community plan-

ning. With these ends in mind, the following policy is suggested:

"The Federal Government might properly offer to pay a certain percentage of the cost of acquisition of land by municipalities, on condition that the municipality, in using such land, should take suitable precautions to insure the sound development of the neighborhood. The Federal Government should be careful not to subsidize the development of neighborhoods of jerry-built houses, nor of surplus residential sections, nor of poorly planned communities. It should offer financial assistance only when municipalities follow a proper and well-considered housing and land-use policy."

Since Mr. Delano made this proposal, it has found expression in limited and experimental form in the legislation of the United States Housing Act of 1937, creating the new United States Housing Authority. Under the provisions of that Act, limited sums have been made available for allocation to municipal housing authorities for the purpose of acquiring and developing lands for low-cost housing. Because the Act has been in force for only a brief period, the experience with its operations is not yet sufficiently broad to provide a basis for a reasoned opinion as to its effectiveness and adequacy.

Parallel proposals for relaxing the constitutional restrictions on the powers of state governments, with a view to permitting them to make loans and grants to municipalities for the purpose of acquiring and developing lands for low-cost housing, are under consideration in several states. Some students of the financial history of state governments show a tendency to doubt both the wisdom and the effectiveness of these proposals. They point out that the existing limitations on the powers of state governments to incur debts, and on the purposes for which moneys may be appropriated, grew out of the extravagant exercise by the states of their previously unlimited powers to borrow and expend money for purposes which in their day were considered not only "public" in character, but essential to the development of the local governments. Furthermore, in several of the states where the housing problem is most serious, even a substantial increase in the already onerous state debts would hardly permit state loans and grants to local units on a scale sufficient for the solution of that problem. Whether those states can adjust their revenue systems, already strained to the limit in some instances, to support a considerable increase in their fixed charges, or can reduce their expenditures for other purposes sufficiently to carry the load, is a matter for debate.

A third proposal has already developed its ardent advocates, partly because it is a necessary supplement to the first and second; partly also as an independent remedy. It involves the exemption from municipal debt limits of loans for housing purposes, whether the sums borrowed are derived from superior public agencies or from private sources; and the redefinition of the term "public purpose" so as to bring housing within its scope. Here again, existing debt loads and relatively inflexible revenue systems provide the basis for serious doubts as to the wisdom and adequacy of this proposal for the acquisition and development of municipal land reserves for housing or other purposes.

A fourth but much sounder proposal has already been put into practice in a small way in San Mateo County, California. A provision of that County's new charter, in effect in 1933, made it possible to set up a land acquisition fund by resort to recurrent annual tax levies. More than three miles of beach frontage had been acquired out of the proceeds of that fund prior to November, 1936,

and negotiations were under way for the purchase of five miles more.[5] Unfortunately, constitutional tax limits in some states, restrictions on the purposes for which tax levies may be imposed in other states, and strongly organized opposition to the expansion of municipal budgets in practically all states interpose obstacles to the widespread use of this eminently sound and practicable method for acquiring lands which should be held in common.

In short, limitations exist at present on the capacities of the national, state, and local governments to finance acquisition of municipal land reserves by purchase. Restrictions on the state and local governments are of a dual nature. They exist first in constitutional limitations which in turn are the products of unhappy experiences in the past. Removal of these, however, can have little effect on the economic limitations inherent in the revenue systems of those levels of government.

Limitation on the capacity to extend national aid to local governments is for the moment merely statutory. It could be removed at any session of Congress. The control over currency, banking, and credit which the Federal Government exercises would enable it for the time being to place almost unlimited sums at the disposal of local governments for any purpose whatsoever. While some immediate extension—perhaps a doubling—of federal aid for slum clearance and low-rent housing seems desirable, the excessive use of federal financing, on the other hand, would bring inexorable economic limits into play, as it has throughout the greater part of the European continent. The rehousing of fractions of the population in structures which meet more or less adequately the current but ever evolving concepts of minimum standards of health and decency, cannot be considered an unmixed blessing if the means of financing employed must inevitably bring in its train reduced standards of food, clothing, and fuel for the population as a whole.

Public Land Reserves in Fact—if not in Name

The limitations just cited do not mean, however, that municipalities are wholly and forever debarred from acquiring lands suitable for general purposes, and from holding them as a reserve until need for their use arises. In fact, without intending it, a large number of municipalities have already bought extensive areas of lands within their borders, and have been making installment payments on the purchase price out of current revenues during a number of years past. Since the lands involved were selected by chance and therefore planlessly, they are heterogeneous in character, and dispersed in location. Title has not yet been vested in the local governments concerned. That step awaits the payment of a final installment in the form of costs of foreclosing the outstanding tax liens. Even after the municipalities take title, some time must elapse before they can ascertain the uses to which the lands are adapted, and before they can take the necessary steps to consolidate their holdings by exchanges with the private holders whose lands now lie interspersed with the extensive areas which already constitute a public land reserve in fact if not in name.

Facts have not yet been compiled for any large number of municipalities which would substantiate this startling generalization. Ernest M. Fisher published in 1928 his findings comparing

[5] Hugh R. Pomeroy, "San Mateo County's Land Acquisition Program," *The American City*, November, 1936, p. 79.

the growth of the number of lots in subdivisions with the growth of population in nine urban areas.[6] In all these areas he found that a large oversupply of lots in subdivisions had been characteristic of the regions throughout their history, and that an unusually large surplus had been created during the most recent boom.[7] In 1932 he published a more intensive study of the situation in the Grand Rapids region,[8] in which he explored, among other things, the waste of public and private funds which had been involved in the excessive subdivision in that area.

In the previous year Herbert D. Simpson had published his study of the situation in Chicago, and in the outlying municipalities in Cook County.[9] He compared the existing oversupply of vacant lots with the estimated future increase of population, and found that more than enough lots were already in existence to meet all probable needs for the next three decades. He found, further, that one effect of the oversupply was to make it necessary to resort to a process of discounting the probable future values in order to arrive at any defensible present value.

Subsequently, studies along the same lines revealed the existence of comparable situations in Minneapolis, Denver, San Diego, and Los Angeles. Some of the studies of insolvent municipalities in Florida made for committees of bondholders seem to have been the first to develop facts concerning the status of the enormous excess of vacant lots with respect to tax payments. Excellent and revealing as these studies were, their effects in enlightening the general public were as a rule limited by the fact that they were made available only in manuscript or mimeographed form.

It remained for the Michigan State Planning Commission to publish the first detailed analysis of the vacant-lot situation with respect to tax payments. The study dealt primarily with conditions in Redford Township in the Detroit area and revealed that a total of 27,183 lots had been provided, of which only 1,179 had been utilized; and that more than 60% of the vacant lots had ceased to pay taxes in 1932 or earlier. The report comments that "taxes on vacant lots are delinquent to an extent that suggests abandonment of such lots by a large proportion of the owners."[10]

A New York State Study of Premature Subdivisions and Tax Delinquency

A report issued in 1938 by the New York State Planning Council presents information on the extent of premature subdivision in 8 cities and 62 towns, distributed in four of the state's largest metropolitan areas. Excessive numbers of vacant land parcels were found to exist in practically all of the 118 separate governmental areas included in the study, a small handful of compactly built villages with areas of one square mile or less being the only exceptions. The heaviest concentrations of vacant and presumably unused lots and lands in the Buffalo, Rochester, and Syracuse metropolitan regions were found to lie on

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[6] Of these, five—Detroit, Grand Rapids, Flint, Lansing, and Ann Arbor—were in the state of Michigan; two—Cleveland and Toledo—in Ohio. The remaining urban areas subjected to scrutiny were Milwaukee and Birmingham (Ala.).

[7] Fisher, Ernest M., *Real Estate Subdividing Activity and Population Growth in Nine Urban Areas* (Ann Arbor: University of Michigan, 1928).

[8] Fisher, Ernest M. and Smith, Raymond F., *Land Subdividing and The Rate of Utilization* (Ann Arbor: University of Michigan, 1932).

[9] Simpson, Herbert D. and Burton, John E., *The Valuation of Vacant Land in Suburban Areas* (Chicago: Institute for Economic Research, 1931).

[10] von Storch, Earl G., *Report of the Subcommittee on Suburban Subdivision Development* (Lansing: Michigan State Planning Commission, 1937).

either side of the boundaries of the central cities, with the greater number of such lots occurring in the suburban town adjacent, or in close proximity, to the central cities. In the larger metropolitan area centering on New York City, the pattern of premature subdivision was modified by an outward thrust along railway lines, glaring examples having been found almost 40 miles beyond the boundaries of the central city.

Like the Michigan study, the New York study developed information on the status of the vacant lots with respect to tax payments. In 5 of the 8 cities, and in 47 of the 62 towns, information was compiled, property by property, on the accumulated arrears of taxes and special assessments. The total arrears tabulated, exclusive of penalties, amounted to $34,500,000, of which the arrears on vacant lots represented more than 2/3. The tax rolls of the 52 cities and towns included in this sample contained 293,000 vacant land parcels, of which more than 1/2 appeared on the lien registers on which unpaid taxes and assessments were recorded. Wherever the tax rolls included an abnormally large proportion of vacant lots, the lien registers showed that a disproportionately large percentage of those vacant lots was in arrears; and that the arrears of taxes and special assessments which had accumulated against the vacant lots comprised the major fractions of all delinquent levies outstanding. This relationship between excessive subdivision on the one hand and excessive delinquency on the other was apparent in the outlying wards of central cities; in suburban cities, towns and villages; and in the outlying rural towns on the fringes of the metropolitan regions. This fact warrants the assumption that the same relationship exists also in those regions where the earlier researches by Fisher and Simpson revealed the existence of vacant lots far in excess of any reasonable need.

In order to throw light on the attitude of the owners of record toward the vacant lots in arrears, all properties of that type in three cities and 27 towns were distributed by the years in which they first appeared on the records of unsalable tax liens. This sample included slightly more than 100,000 properties. Of this number, almost 2/3 were found to have ceased tax payments as long ago as 1930; almost 1/5 as long ago as 1926. One group made up of 10,000 lots in widely separated outlying towns, which were not included in the analysis just described, was found to have gone into arrears shortly after the collapse of the subdivision boom of 1895, and to have remained in arrears ever since. These facts sustain the contention of the Michigan State Planning Commission that many of the vacant lots in arrears have to all intents and purposes been abandoned by the owners of record.

Who then does own them? Buried as they are under a multiplicity of public and private liens, it is obvious that no individual can give clear title to them. Until such time as the tax liens are foreclosed, large numbers of these lots must remain unused and unusable for either public or private purposes. Two obstacles have until recently stood in the way of foreclosure—official inertia and the high costs of the foreclosure proceeding. About five years ago, circumstances arose which have tended, if not wholly to remove, then at least to reduce the magnitude of those obstacles. Since that time the counties, cities, or towns included in the study have acquired salable and insurable titles to well over 20,000 of the vacant lots in arrears—titles based on the foreclosure of liens which it had cost the tax-paying property owners in those areas of government millions of dollars

to acquire. The local governments have thus unintentionally bought and paid for a land reserve of some magnitude, through the workings of the budget, tax, and bond laws under which they operate.

None of these local governments has yet realized the advantages of holding these lands in reserve. Each is trying to sell them, allowing the purchasers to pick and choose more or less at random among the public holdings. Evidence is accumulating, however, that the excessive number of lots will be no more readily salable as lots by the local governments than they proved to be in the hands of the former owners; and that replanning and replatting must precede any successful program for putting the lands to use, whether in public or private hands. When those facts shall have been demonstrated by experience, it is to be hoped that the planners may succeed in guiding local governments to a realization of the wisdom of withholding selected areas not only from sale, but also from dedication to permanent park and recreational uses. We shall then find fewer situations like the following one:

> "The City of Boston now holds tax titles on 10,000 properties valued at $7,730,000, according to a recent statement of City Collector Merrit Thompson. In addition, Mr. Thompson referred to tax titles that have been foreclosed by the City on properties valued at $590,000. The monthly income in rents from these properties is about $1,300, an indication of their poor condition. Since there is no tax income from property that has been foreclosed in this manner, every effort is made to enable the owners to redeem them or to buy them back from the City, or to interest other private purchasers. Some thirty parcels have been sold during the past year."[11]

Much remains to be done before local governments can acquire valid title to all the vacant lands for which they have been paying the price throughout many years. With all the progress that has been made, foreclosure costs remain disproportionately high when the values of the more poorly located lands involved are taken into account. A carefully drafted bill designed to reduce these costs to a minimum was introduced in the Legislature of New York at the last session, but failed of passage. The caliber of the committee which drafted it is such as to commend the bill to municipalities in other states which are confronted by analogous problems.[12]

Whenever foreclosure costs can be reduced, municipalities in state after state will be in position to take title to extensive land holdings—holdings which in fact they have already bought and paid for.

The Bearing of Zoning and Planning Procedures

Certain facts remain to be commented on. Zoning boards and planning commissions had been established in most of the urban and suburban municipalities of New York for which the study was made. They had certainly done little to guide or check the madness which led to the waste of public and private funds in the premature subdivision of rural lands for urban purposes. There is even some ground for the belief that the widespread tendency to overzone helped to accentuate the madness.

Even the staunchest advocates of zoning have come to see that overzoning for business and multi-family uses is a fault common to most ordinances both in urban and suburban areas. Very few see, however, that the most serious overzoning has often taken place in the most highly restricted of all zones—that for one-family residence. That happens

[11] *News Letter*, Housing Association of Metropolitan Boston, February, 1938.

[12] Senate Introductory 138, Feld; Assembly Introductory 147, Phelps.

to be the least intensive use-zone in the typical ordinance. When one views as a whole all the separate zoning ordinances in a metropolitan area, it becomes obvious that that zone has been applied to extensive areas not only within the central city but to even larger areas in the suburban and rural municipalities; and that much of the land included in it is not now, and may never be, ripe for even so intensive a use as one-family houses on small plots. In areas where the only economic uses are 100-acre farms, 40-acre estates, or 60-acre woodlots, it is idle to zone for close occupancy in one-family residences, even if we invite the displeasure of the courts by requiring minimum lot sizes of one, two, or five acres. In short, when all the outlying lands within our city limits and for miles and miles beyond their boundaries are zoned for uses to which they cannot possibly be adapted, we are courting disaster. Worse still, we are depriving the existing uses of the protection to which they are entitled, and without which many of them must disappear; and we are providing bait for suckers to be used by shoestring promoters of so-called home developments on which no real home can ever exist.

In order to stabilize values in such areas, and to protect existing uses against incompatible and destructive intrusions, we shall have to learn that zoning of the conventional urban type is wholly inadequate in many suburban and rural areas whether those areas exist inside or outside the city limits. That such areas may have the benefits of zoning, we must discover how to bridge the existing gap between the most intensive use for which provision is made in the rural zoning ordinances of Wisconsin and the least intensive use characteristic of developed urban centers. The problem is how to provide for the many varied and indispensable uses which lie between the two extremes.

The related problem of subdivision control demands increasing attention also. To a gradually growing extent municipalities are gaining and exercising the power to regulate the chopping up of land into building sites, and are requiring the installation of paving, sidewalks, and utilities (or a bond therefor) prior to the sale of lots. Ill-planned and excessive subdividing may thus be lessened and a much-needed reduction in hardships to prospective home-owners and in future tax delinquency may be achieved.[13]

The Place of Taxation in the Problem

The long-run effects of methods of taxation cannot safely be ignored in any realistic consideration of the factors which must affect the establishment of any municipal land policy whatsoever. This is true whether that policy be limited to acquisition and development of lands for low-rent housing; whether it be broadened to include acquisition of municipal land reserves comparable to those maintained by many European cities; or whether all lands within a municipality, both in public and in private ownership, are to be brought within its scope.

It is possible to levy taxes in such a way as (1) to increase the cost of food, clothing, and fuel, thus reducing the margin of personal income available for payment of rent or for capitalization into the purchase price of a home; (2) to increase the cost of the labor and the materials which enter into the cost of construction; and (3) to increase the cost of operating and maintaining build-

[13] For an excellent analysis of recent legislation of this type, see "New Planning Laws Strengthen Subdivision Control," by Wayne D. Heydecker in *The American City*, June, 1938.

ings. Any system of taxation which does these things makes it more difficult for private builders to meet the housing needs of the lower-income groups, and enlarges the field within which government subsidy is required. At the same time—all other things being equal—this kind of tax system makes it easier for private owners to hold well-located and desirable lands out of use, and therefore increases their bargaining power when builders negotiate for sites, whether those builders be private individuals or public agencies.

The importance of taxation in the problem of slum clearance can hardly be overestimated. The replacement by private initiative of old and obsolete buildings by modern buildings will, under our present tax system, lead inevitably to a substantial increase in the annual tax bill on the property. The better and more adequate the building which replaces the slum, the greater the increase in the recurrent annual bill for local taxes. Only philanthropists, therefore—and few of them—will undertake such operations for low-rent housing when they know in advance that increased taxes on the property must be deducted from the rigid gross rents per unit before any allocations can be made to operation and maintenance, or to the fixed charges on invested capital. In short, we subsidize those who maintain slum dwellings and penalize those who would replace them. As long as we persist in maintaining this absurdity in our existing tax system, we shall make little progress in clearing our slums beyond the extent to which the state or federal governments take over the task or provide subsidies sufficient to offset the effects of the penalties imposed on the private builders who might otherwise attack the problem as a business venture.

So much for the negative effects on municipal land policy which inhere in our present system of taxation. On the other hand, it is possible to devise a system of local property taxes which would decrease costs of construction, as well as of operation and maintenance, and thereby increase industrial activity, employment, and the effective level of wages. Progressive lowering of the tax rate on all buildings and increasing the tax rate on land would decrease the tax burden on home owners and on tenants of low-rent housing projects and would advance the public welfare through properly penalizing those who would hold desirable land out of use in order to speculate on the chances for sale at a profit when more intensive uses become possible. It would thus become an effective weapon against the forces which today make almost impossible the public acceptance of a zoning ordinance that does not set aside for business, for multi-family residential uses, and for single-family uses larger areas than can ever be used for those purposes; and which enable holders to maintain the prices of unused or partially used lands in each zone at levels so far above capitalized earning power that adequate development of the lands becomes economically impossible.

I. Obsolescence of Public Utility Property

By C. EMERY TROXEL*

LIKE unregulated industries public utilities find from time to time that their equipment, method of rendering service, and even their type of service are outmoded. More public utility property has probably been retired for these reasons than for wear and tear or action of the elements. Development of utility industries may be traced, indeed, in terms of changes in equipment used for performing utility services or displacement of one utility service with another.[1] In electric utilities economical boilers, turbines, or generators are from time to time reducing the unit cost of electricity. In fact, this lower per-unit cost of a larger and larger scale of electricity output has resulted in abandonment of many smaller plants in favor of ever larger and allegedly more economical central stations. Motor busses have been gradually replacing street cars or one-man cars, and lighter and faster cars displace more costly, heavier street cars. Dial systems are gradually being substituted for manual switching boards, chiefly in the larger cities. Recent technological changes in gas pipe-line construction will alter the future character of this utility as well as probably result in abandonment of many gas-manufacturing plants.

Such technological changes affect the service-life of existing equipment and thus give rise to significant regulatory problems respecting valuation, depreciation allowances, and plant growth. Likewise, a recounting of these past plant changes forecasts the possibility of other revolutionary, but usually unpredictable, future changes in the arts of rendering utility services. Obsolescence, or supersession as it is sometimes more broadly termed, will here be considered first as to its nature, measurement, and the desirable regulatory policy with respect to it, and finally (in Part II) in terms of court and commission treatment of several aspects of the problem.

Nature of Obsolescence

Obsolescence will here be treated as the loss in an investment in property resulting from inventions or technological changes. New techniques in utility industries have been principally of two types. First are those technological changes which result in unit-cost-reducing improvements, such as seamless or welded steel pipe for natural-gas lines. This is probably the more common type of technical change among utility companies. Second are the mechanical changes which improve the quality of service irrespective of changes in unit costs, as illustrated by faster street cars or by fewer interruptions in electric service. Thus, obsolesence is a matter either of technical efficiency in producing a service or good which may be measured (at least theoretically) in terms of costs or of mechanical perfections in the service or good which result in an increase of gross income.

Customarily the definition of depreciation encompasses among other things both obsolescence and inadequacy.[2] Al-

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[1] For a recent account of realized and possible future technological changes in utility industries see National Resources Committee, *Technological Trends and National Policy* (Washington: Government Printing Office, June, 1937), c's III, IV, V and VII).

[2] Inadequacy, which will not be specifically treated here, although regulatory policy respecting it should generally be the same as for obsolescence, chiefly results from an increase in demand necessitating plant enlargement. An electric generating plant, e.g., may be

(*Footnote 2 continued on page 267*)

though the Interstate Commerce Commission observes "that important factors which limit service capacity are predominantly factors that do not produce deterioration," it defines depreciation as:[3]

"... the loss in service value not restored by current maintenance and incurred in connection with the consumption or prospective retirement of property in the course of service ... which are known to be in current operation, and whose effect can be forecast with a reasonable approach to accuracy."

This is merely a lumping together of the several ways in which the investment in assets declines, a common procedure of utility accounting systems.[4] Thus, among utility companies and commissions, as for other enterprises, a single depreciation allowance (or per cent of accrued depreciation) is determined as a composite of these factors which affect asset values. Determination of all types of depreciation by loss in service capacity will include obsolescence when service capacity is "measured on the basis of the number of units of service or of articles of output which the facility can *economically* produce."[5]

Something about the occurrence of obsolescence should be observed. Property may be partially obsolete long before it is abandoned. It would be as fair to say that no obsolescence exists in property until property is abandoned, even though cost reductions merit use of improved equipment, as to say that no physical depreciation has occurred in equipment until it is replaced or abandoned. Whenever an improvement is available for installation, obsolescence exists in the less efficient, less modern installed equipment or plant, though this installed equipment may not be immediately replaced. If per-unit cost of production may be reduced by installing improved machinery, the investment in existing machinery with a higher per-unit cost has declined in accordance with the decrease in per-unit cost of service production.[6]

Measurement of Obsolescence

In public utility analyses of depreciation no attempt has been made, customarily, to determine the annual depreciation allowance by separate consideration of functional depreciation.[7] First, it should be noted that equal annual depreciation quantity or percentage allowances, admitting the convenience of uniform figures, do not assure measurement of obsolescence. This applies equally well to straight-line, sinking-fund, or other methods. Only by coinci-

(Footnote 2 continued from page 266) replaced by a larger plant of the same type. It may be of interest to note, however, that obsolescence is usually considered to be the result of a decrease in demand for a firm's output (an increase in unused capacity), especially where an entire industry is incurring a decrease in demand for its service. Obsolescence may be associated, however, with an increase in demand as, for example, in the electric industry.

[3] *Telephone and Railroad Depreciation Charges*, 177 ICC 403 at 422 (1931).

[4] All recent revisions of public utility systems of accounts recognize that the "causes [of depreciation] to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities." FPC, *Uniform System of Accounts for Public Utilities and Licensees* (1936); Nat'l. Assn. of R.R. and Util. Commissioners, *Uniform System of Accounts for Electric Utilities and Uniform System of Accounts for Gas Utilities* (1936); FCC, *Uniform System of Accounts for Telephone Utilities* (1935).

[5] Wis. Pub. Serv. Com., *Depreciation: A Review of Legal and Accounting Problems* (New York: State Law Reporting Co., 1933), p. 15.

[6] At the same time the property may be depreciating for other reasons, and per-unit cost reductions or increases in net income may result, of course, from other causes than technological changes.

[7] Cf. Wis. Pub. Serv. Com., *op. cit.;* Wilcox, Delos F., *Depreciation in Public Utilities* (New York: National Municipal League, 1925), pp. 5, 21–5; Riggs, Henry E., *Depreciation of Public Utility Properties* (New York: McGraw-Hill, 1922), pp. 100–2, 131–40; Graham, Willard J., *Public Utility Valuation* (Chicago: University of Chicago Press, 1934), pp. 31–2, 40.

dence will a percentage depreciation rate or quantity of depreciation expense fixed in the present apply to future declines in asset values, unless the depreciation allowance is frequently readjusted to allow for functional deterioration of investment or unless obsolescence and companion sources of depreciation may be quite accurately predicted. It probably is easier, moreover, to predict inadequacy resulting from population or industrial changes than obsolescence resulting from new inventions which may not yet be conceived in the mind of the inventor. For any obsolescence prediction there may be a wide margin of error. Second, it is doubtful whether "life tables" of property can accurately measure future changes in functional depreciation no matter what approximations of service-life are made by the turnover, mortality, forecast, or similar methods.[8] These are first approximations, for they are based on past retirements. If cost-reducing improvements occur in the future at the same rate and effect per-unit cost reductions as they have in past years, use of these methods of estimating service lives will, of course, provide a means of predicting obsolescence. But who could have predicted in 1920 the date of the coming of long-distance gas pipe lines, the investment they would require, the cost of operating them, and the consequent obsolescence of much gas-manufacturing equipment? The desirability of an annual depreciation allowance which includes obsolescence, even though there be even a bold estimate in calculating the obsolescence part of the allowance, will be subsequently considered (in Part II) in connection with court and commission opinions.

For the purpose of discussing measurement of obsolescence cost, technological changes will be segregated into those which may and those which will not be used by the company using existing equipment. When use of a technical change may be within the control of the company using the old equipment, measurement of obsolescence cost will be in terms of per-unit cost reductions and/or per-unit revenue changes. This differentiation is especially applicable to changes, say, in a turbine for an electric company which has a monopoly of the sale of electricity within a given area; but it becomes less significant when competitors—even competing utility companies—may have a similar choice. Use of some technological changes, however, may be beyond control of the company using the existing equipment, as illustrated by displacement of street cars by automobiles. Commissions commonly call it "extraordinary" obsolescence.[9] Measurement of the effect of the latter sort of technological change will be in terms of a company's net-income decline or deficit increase.

When the regulated company may control installation of a technical change obsolescence cost may be at least approximated by discounting—at the average rate of interest on the company's capital and for the period of the estimated remaining life of the existing equipment—the annual increase in net income or the difference between per-unit cost of production of old and new equipment times the capacity of the old equipment. This method of calculating obsolescence cost may be most suitably applied to each technical change

[8] An excellent description of these methods may be obtained in Wis. Pub. Serv. Com., *op. cit.*, pp. 165–85.

[9] Most technological changes for rendering utility services have been installed by industries or companies that are affected by such changes. Differentiation of obsolescence cost according to whether or not the companies affected by a technical change utilize the improvement will be treated further in the succeeding sections (in Part II) on regulatory practice.

instead of a group of such changes. Likewise "extraordinary" obsolescence cost may be measured by discounting in a similar manner the decline in future net income. Inclusion of a mathematical statement on these measures of obsolescence cost has been omitted because it was feared that confusion rather than clarification would result.[10]

The results of the above-described discounting process provide a means of measuring the time when old but not fully depreciated equipment may be abandoned. Where a company possessing the old equipment may control installation of improved equipment, the old equipment will be abandoned when the present (discounted) value of cost reductions or net-revenue increases from use of the new equipment exceeds the present value of the remaining, undepreciated investment in the old equipment. Under these circumstances the company's net income with use of the new equipment would be greater than when old equipment is used, even though some of the economies from use of new equipment are annually used to amortize the remaining investment in existing equipment. This reasoning applies to a regulated as well as a competitive company or industry. Where the same company possessing existing equipment does not control installation of the new equipment, slightly different reasoning on time of abandonment applies. Here abandonment of old equipment will occur when the company's gross revenue will no more than equal its variable expenses. Whenever more than the variable costs are covered by revenue, the utility company, like any other enterprise, will continue to operate though it incurs deficits, for some of the investment will be returned by the excess of revenue over variable costs.

That obsolescence occurs can scarcely be doubted. But measurement of the exact amount of obsolescence cost resulting from a particular technological change may be impossible. It may not be easy for a company to calculate the difference between per-unit cost of production with old and new equipment. Even more problematical would be calculation of increases in future gross and net revenue which might be obtained from improvements leading to a betterment of the "quality" of the service. Distinction between the effects, for example, of use of automobiles and other influences on the net revenue of street railways may not be easily done. Thus the above-described procedure provides nothing more than a means by which obsolescence cost may be approximated.

Summary of Desirable Regulatory Practice

Before presenting court and commission opinions in the succeeding installment of this article, a summary of the manner in which commissions should treat obsolete property and obsolescence cost is needed. This section is not, consequently, a summation of prevailing regulatory practice. Rather it is a statement of suitable commission treatment of obsolescence cost irrespective of commission opinions. Consideration will be given to obsolescence cost resulting from installation (1) of improved equipment by the same company which has incurred the obsolescence and (2) of technological improvements by companies or industries other than those which suffer the obsolescence.

As previously noted, a company will not displace old with improved equipment unless the present value of savings

[10] A partial mathematical statement of this method of measuring obsolescence cost may be found in the writer's "Economic Influences of Obsolescence," 26 *American Economic Review* 280 (June, 1936).

from use of new equipment exceeds the remaining unrecovered investment in the old equipment. But where a company may gain by abandoning existing equipment, profits will accrue above the sums annually needed to amortize the remaining investment in old equipment. This increase in net revenue above the amount needed for amortization of the undepreciated investment in discarded equipment may be (1) retained by the company, (2) taken by customers in commission-ordered rate reductions, or (3) divided in some arbitrary manner among customers and stockholders. Even though commission-ordered rate reductions were sufficiently frequent to make possible the transfer of all these cost reductions to consumers, it would be an unwise regulatory policy. If all savings or even all profits above amortization cost from such improvements were given to consumers by means of rate reductions, no company would care to make improvements, unless it was incurring deficits which could be partially or wholly erased by using the improved machinery. A company, likewise, should not be permitted to keep all such increases in revenue all the time unless, as above noted, the company is earning less than a fair return with the old equipment. Some of the saving resulting from use of cost-reducing machinery must in any case be left with the stockholders. Otherwise the inducements to make such improvements will be weakened and possible rate reduction from these changes may not be obtained. With the prevailing infrequency of rate investigations—each regulated company is not usually investigated each year—companies have an opportunity, however, to retain all or part of the savings from technological improvements.

If replacements of existing equipment are made before the property is fully depreciated, the task of disposing of the remaining investment confronts the company and commission. A regulatory body may conclude (and some have), as the Supreme Court did in the Knoxville Water Company case, that if a company "... fails to perform this plain duty and to exact sufficient returns to keep the investment unimpaired ... the fault is its own."[11] If one's reasoning is not restricted to consideration of depreciation of an investment in a single property unit but is instead applied to the whole depreciation policy of a company, this may be a defensible regulatory practice. When a company has a depreciation reserve several times as large as the avowed accrued depreciation, it does not seem inequitable to investors to require the writing-off of remaining investment in abandoned, obsolete equipment to the depreciation reserve. Indeed, in this situation such practice may not deter installation of improved equipment, although the commission might be obliged to order the installation. Likewise, payment of excessive dividends may justify this procedure. Or, the commission may choose to anticipate nearly all obsolescence cost through liberal depreciation allowances, although, as indicated later, this may be difficult. Each case, therefore, may involve considerable judgment by the commission on past and prevailing dividend and depreciation policies in their relation to obsolescence cost.

It is not unlikely, however, that the depreciation reserve may be inadequate for coverage of the undepreciated investment in abandoned, obsolete equipment as well as for coverage of other types of depreciation. The technological improvement, for instance, may appear (before a company has had sufficient time to accumulate an adequate depreci-

[11] 212 U.S. 1 (1909).

ation reserve) to cover the effect of the improvement on an existing investment. Though Mr. G. C. Gilfillan finds some means of predicting inventions and cites evidence of predicted inventions, he observes that the year of appearance and per-unit cost of production are among the most conjectural features of forecasted inventions.[12] In view of the difficulties of predicting technological changes, perhaps calculation of obsolescence cost should usually be stayed until the improved machinery may be purchased and until its cost and other operation characteristics are known.

In the absence of offsetting factors, such as payment of exorbitant dividends, it is desirable that the company be permitted to amortize the remaining investment in the old equipment out of the annual increases in net income resulting from cost reductions or revenue increases from use of the improvement. If under these circumstances this is not the procedure of the regulatory body, technological changes of this sort would be delayed until the company accumulates an ample depreciation reserve.[13] Nor should a commission, in the absence of any of the offsetting factors, order a rate reduction equal to the net revenue increase from use of an improvement, even though the company is allowed to amortize the remaining investment in existing equipment. The improvement might not be made if the company can only "break even." To ban amortization of the remaining investment in installed equipment and to deny even a slight gain in net income from use of an improvement will forestall an opportunity for lower rates from technological changes.[14]

Under the circumstances assumed in the forepart of the preceding paragraph, the difficulty of forecasting obsolescence may lead justifiably to the conclusion that the unrecovered cost of obsolete property " . . . is considered as a part of the cost of replacement" and that this cost may be " . . . charged against the output of the period which gets the benefit of the more economical machinery."[15] Since the utility consumers who use the new equipment obtain the benefits of its use, especially if rate reductions result because increases in net revenue are more than sufficient to provide for amortization of the remaining investment in discarded equipment, it would not be unreasonable to charge off obsolescence cost to operating expenses of future years.[16] When obsolescence cost may be paid for out of increased earnings from the use of a technological change, it is possible, though all companies would not consciously do it,[17] to forego inclusion of estimates of such obsolescence in depreciation allowances during the years preceding installation of the improved equipment.[18] These statements should not be taken to mean

[12] National Resources Committee, *op. cit.*, pp. 15–23.

[13] It may be claimed that utility companies receive rates of return designed to cover the obsolescence risk and that, therefore, no amortization of remaining investment in obsolete equipment should be allowed. If rates of return are calculated to cover this risk, the regulatory policy proposed here would call for reduction of the rate of return. Yet there seems to be no adequate means of forecasting this risk. But allowance for the risk in the rate of return supposes ability to forecast it. Furthermore, commissions might be obliged to force companies to install improvements for which allowances were previously made by means of the rate of return.

[14] As a practical procedure this general policy might be applied only to large units of property, even though in reality it might be applicable to the smallest unit.

[15] Saliers, Earl A., *Depreciation* (New York: Ronald Press Co., 1923), pp. 28, 33.

[16] Mr. Willard Graham prefers to charge obsolescence cost by means of an "obsolescence reserve" to past operations, because "it is hard to see just how consumers in future periods can benefit from past errors in depreciation allowances." (*Op. cit.*, pp. 31–2.)

[17] Notable exceptions probably may be found among the companies which use or have used retirement reserve accounting.

[18] But companies may not wish, of course, to run this risk of impairing their investments.

that a depreciation reserve, which will partly or wholly cover obsolescence cost, need not be accumulated. If the same customers using the obsolete equipment will also use the improved equipment (and they may well be substantially the same customers), it really makes little difference when the obsolescence cost is amortized. But companies must be prevented from amortizing the investment twice.

Frequently, as will be apparent in the second installment, commissions and courts in adhering to the "used and useful" criterion of property to be included in fair value refuse to allow property, which has been replaced by improved equipment, to be included in the rate-base. Rather than have a mounting rate-base with a corresponding increase in the allowable return when there is an accumulation of obsolete property, it is more desirable to write off obsolescence cost to (1) the depreciation reserve when a portion of the reserve has been accumulated for this purpose, when the depreciation reserve is excessive, or when dividends have been excessive,[19] or (2) to operating expenses after installation of the improvement when no adjustment is needed because of the company's past depreciation or dividend policy.

The same analysis may be applied to inclusion of sums for existing obsolescence in calculations of accrued depreciation. If depreciation allowances have included something for anticipated or existing obsolescence, i.e., the depreciation reserve is large enough to cover existing obsolescence, or if dividend payments have been exorbitant, accrued depreciation estimates should usually include sums for accrued obsolescence even though none of the property is sufficiently obsolete to warrant its abandonment.

No consideration has yet been given in this section to obsolescence which results from utilization of the technological change by a company or industry other than the one which incurs the obsolescence. Obsolete property of this sort has previously been illustrated as street railway property which has been replaced by automobiles or gas lighting systems which have been replaced by electric lighting systems. Obsolescence cost arising in this manner usually cannot be assessed against future buyers of the service, because these purchasers are turning to the use of more desirable alternatives. If this cost is to be collected from customers, it must be charged against past operations in order that investors will be reimbursed through adequate depreciation reserves, or stockholders may have received high dividends in the absence of adequate depreciation allowances. Otherwise it is a loss for investors. The chance that a service, good, or industry will become outmoded in this manner is an investor's risk.

The final installment of this article will consist of an analysis of the court decisions and commission opinions which have dealt with the problem of obsolescence of public utility property.

[19] If dividends have been excessive, it may be necessary to order the write-off of remaining investment in obsolete equipment to surplus.

The North Dakota Rural Credit System

By GILBERT W. COOKE*

CONFRONTED in the last two decades with agrarian discontent over alleged insufficient private credit institutions, three northwestern states—Minnesota, South Dakota, and North Dakota—established state-financed rural credit systems to furnish long-time loans on rural real estate. This article analyzes the behavior of one of these three experiments.[1] It is significant today as an example of what may happen to a portion of the expanded program of the Farm Credit Administration.

I. Political and Legislative Background

Although proposed as early as 1891 and recommended by Governor John Burke in his farewell address to the Legislature in 1913, the North Dakota rural credit program did not receive effective support until sponsored by the Non-partisan League in 1915.[2] As one of its major planks,[3] the League took the initiative in 1919 in obtaining constitutional amendments and enabling legislation for creation of a rural credit system.

Removal of the constitutional limitation on state loans was accomplished by an initiated amendment in 1918 providing that "the state may issue or guarantee the payment of bonds, providing that all bonds in excess of two million dollars shall be secured by first mortgages upon real estate in amounts not to exceed one-half of its value . . . "[4]

The legislative program for executing the provisions of this amendment resulted in an Industrial Commission composed of the governor, attorney-general, and commissioner of agriculture and labor; a Bank of North Dakota; and an issue of North Dakota bonds—real estate series. The Industrial Commission was empowered to manage, operate, control, and govern all state institutions except those of a charitable, penal, or educational character. Using such powers, it supervised the issuance of bonds and managed the Bank of North Dakota.[5]

The Bank of North Dakota is a state-owned and -operated bank intended primarily as a depository for public funds, a clearing-house for state banks, a central bank for reserves, and a lending agency for state institutions, private banks, and governmental subdivisions. In connection with the rural credit system, the Bank had a double function: (1) it was authorized to make loans to resident farmers on real estate secured by first mortgages not to exceed ½ the value of the security, and the total of those loans must exceed neither 30% of the bank's capital nor, in addition, 20% of its deposits;[6] (2) it could assign farm mortgages in blocks of $100,000 to the state treasurer, and receive in exchange state bonds which could be negotiated, sold, and delivered by the Bank of North Dakota, acting as agent of the Industrial Commission.[7]

The Bank of North Dakota received its first public deposits on July 28, 1919 and closed the first farm loan in August, 1919. During the next two years, loans

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[1] Terrance Leonhardy and Wilford Miller aided the writer in compiling statistics and constructing charts.

[2] See Cooke, G. W., "North Dakota State Mill and Elevator," 46 *Journal of Political Economy* 23-51 (February, 1938).

[3] Gaston, H. E., *Non-partisan League* (New York: Harcourt, 1920), p. 60.

[4] Constitution of North Dakota (1918), art. 31, §182.

[5] Laws of North Dakota, 1919, c. 151.

[6] *Ibid.*, c. 147, §15.

[7] *Ibid.*, c. 154, §§2, 4, 6. The first series was limited to $10,000,000.

were made and carried as general assets of the Bank. Because all capital of the Bank had been invested in two million dollars of bank bonds intended to be sold subsequently to secure liquid funds, none of this capital could be used for farm loans; these loans, therefore, were limited in amount to 20% of the public deposits. When the Bank was established, all public funds were ordered to be deposited therein; an initiated act of November 2, 1920 required only state funds to be there deposited, thus permitting withdrawal of local government funds from the Bank. Initial deposits had been about 12 million dollars; tax payments increased this to 29 million dollars, but current governmental expenses reduced the total to 15 million. With passage of the November amendment, however, the deposits fell during 1921 to around 6 million dollars. Maximum farm loans by the Bank proper totaled $2,910,000 on November 15, 1920.[8]

As already mentioned, the legislation of 1919 permitted the Bank to assign farm mortgages to the state treasurer in exchange for state bonds to the extent of ten million dollars. The operation of this law was delayed by the inability of the Bank, acting for the Industrial Commission, to sell the bonds in the public markets until after a decision of the United States Supreme Court had approved the constitutionality of the issue on June 1, 1920.[9] After this decision, the sale of bonds was further handicapped by a series of political maneuvers intended to destroy the entire industrial program. At the primary election Governor Lynn Frazier won a close decision from William Langer, then representing the conservative element, and in the fall election in 1920 Frazier defeated J. F. T. O'Connor by some 5,000 votes. League candidates William Lemke and John Hagan, attorney general and commissioner of agriculture and labor, respectively, also defeated their opponents by close votes. During 1921 a bitter opposition tried to win support for seven initiated proposals to destroy the program and to recall the Commission. On October 28, 1921 the people voted contrariwise: they defeated the proposed laws which would have killed the program but they also recalled the three leaders who had framed and executed the program for two years. Frazier, Lemke, and Hagan lost to R. A. Nestos, S. Johnson, and Joseph Kitchen.[10] This new Industrial Commission, which took office on November 23, 1921, reported in its next annual report that only $1,971,800 of real estate bonds had been sold by December 31, 1921.[11] These sales, however, had reduced the loans held as general assets from the $2,910,000 mentioned above to $820,000 on November 15, 1921.[12] Subsequent reports of the Commission credit the Bank with having closed during 1919, 1920 and 1921 some 755 loans totaling $2,760,331. This ends the first phase of the state rural credit system.

II. Administration and Allocation of Loans

Under a voters' mandate to carry on the industrial program, the new Industrial Commission set up the Farm Loan Department as a separate division of the Bank of North Dakota to handle farm loans. On the Commission's recommendation the voters approved an initiated statute, June 28, 1922, increasing the issuable bonds to 20 million dollars; the Legislature in 1923 cancelled part of the foregoing issue but allowed 25 mil-

[8] Bank of North Dakota, *Bulletin*, November 15, 1920.

[9] *Green v. Frazier*, 253 U.S. 233 (1920).

[10] *Manual for the State of North Dakota*, 1932, Bismarck, N.D., p. 129.

[11] Industrial Commission, *Annual Report*, 1921, p. 18.

[12] Bank of North Dakota, *Bulletin*, November 15, 1921.

lion more. Subsequently, the 1929 and 1931 Legislatures expanded the 1923 amount to 35 million. From these acts a total of $42,750,000 of loans were authorized for rural credit purposes.[13] In 1923 also, collection of interest and principal on the loans was transferred from the state treasurer to the Bank of North Dakota—a collection division being established for that purpose. Under this new arrangement the Bank of North Dakota had, and still has, two distinct departments: the Banking Department handling public deposits; the Farm Loan Department which has a closing division examining applications and assigning farm mortgages to the state treasurer and a collection division receiving the income from farmers to remit to the state treasurer who holds title to the mortgages and pays interest on the bonds. Under this arrangement the Farm Loan Department does not take any responsibility for any loss in principal or interest on the loans or for paying interest or principal on the bonds.[14] It is sort of an in-between agency with powers but no responsibility.

The details of the rural credit system may now be summarized: (1) the Industrial Commission prescribes the forms for application and appraisal of loans; (2) the Farm Loan Department receives the application, directs an appraisal, and closes loans which are approved by the appraiser, the head of the closing section, and a finance committee of the Bank;[15] (3) closed loans are assigned to the state treasurer in batches of $100,000; (4) upon receipt of the mortgages, the state treasurer issues bonds to the Bank which sells them on the open market to obtain funds for the farmer; (5) two contracts are made: one between the farmer and the state treasurer, the other between the state treasurer and the creditor of the bonds; (6) the rate of interest charged the farmer is a function of the rate on the bonds; (7) amortization charges are collected by the collection division of the Farm Loan Department and turned over to the state treasurer; (8) interest on the bonds is paid by the state treasurer out of a Bond Payment Fund.[16]

The legislation concerning the plan of amortization states:

"Every such mortgage shall contain an agreement providing for the repayment of the loan on an amortization plan by means of a fixed number of annual installments sufficient to cover, first, a charge on the loan, at a rate not exceeding the interest rate on the last series of real estate bonds issued, if any, by the State of North Dakota; second, a charge for administration and surplus, at a rate not exceeding one per cent per annum on the unpaid principal, said two rates combined constituting the interest rate on the mortgage; and third, such amounts to be applied on the principal as will extinguish the debt in not less than ten nor more than thirty years; . . ."[17]

In the operation of the amortization law, 16 series of loans were closed, labeled alphabetically from A to P. The percentage of interest and principal for the initial installment together with the period of amortization for these series are as follows:[18]

Series	Percentage of Initial Installment			Amortization Period
	Interest	Principal	Total	
A..........	6 %	1 %	7 %	30 years
B, C, D, E...	6½	1½	8	26 years
D, E*.......	6	1½	7½	28 years
Remainder..	6	1½	7½	28 years

* D and E series were of two types.

[13] Laws of North Dakota, 1923, p. 548; *Ibid.*, c. 292; *Ibid.*, 1929, c. 182; *Ibid.*, 1931, c. 102.

[14] The Banking Department, however, held the bonds as assets and earned about 35% of its gross income therefrom.

[15] Only 1% of the loans were changed by this committee.

[16] Laws of North Dakota, 1919, c's. 147, 154; *Ibid.*, 1923, c. 292.

[17] *Ibid.*, 1919, c. 147, §17.

[18] Letter from A. T. Bellingmier, Bank of North Dakota, April 24, 1936.

The period of closing loans extended from August, 1919 to October, 1933. A total of 16,486 loans amounting to $40,549,972.95 were made; four loans were assumed by the Banking Department and consequently this study is concerned with 16,482 loans totaling $40,505,450.11. Table I presents the number of closed loans, the amount, average loan, and average loan per acre.

TABLE I. STATE OF NORTH DAKOTA FARM LOANS CLOSED BY THE FARM LOAN DEPARTMENT*

Year	Number	Amount	Average Loan	Average Loan per Acre
1921†	755	$2,760,331	$3,656	$14.07
1922	1,077	3,470,691	3,272	12.66
1923	1,984	5,950,500	2,998	11.31
1924	2,213	6,382,600	2,884	11.14
1925	1,804	4,772,100	2,645	9.82
1926	1,330	3,169,150	2,382	9.42
1927	1,202	2,569,700	2,137	8.52
1928	808	1,767,000	2,186	8.44
1929	780	1,616,700	2,072	7.98
1930	1,257	2,546,800	2,026	7.74
1931	2,291	4,074,300	1,777	6.96
1932	928	1,384,400	1,491	6.05
1933	57	85,700	1,507	5.95

* Industrial Commission, *Annual Reports*, 1922–33.
† Includes also 1919 and 1920; figures not given separately.

The basis for territorial allocation of the loans is stated in the *Annual Report* of the Industrial Commission for 1922:[19]

"The allotment of available funds to the respective counties of the first $9,000,000 authorized for making farm loans was on the basis of .0095 per cent of the 1921 assessed valuation of the land in each county. The counties were classified in four groups: those in the western part of the state in District Number One were allotted 200 percent of the base; those in District Number Two, 150 percent of the base; those in District Number Three, the base; and those in District Number Four, the Red River Valley, one half the base percent of the assessed valuation.

"In the second $10,000,000 made available by initiated law, the allotment was the same except that the counties of Burke, Divide, Mountrail, Renville, Ward, and Williams of the Second District were included in the First District allotment base."

The effect of this allotment scheme is pictured on Chart I which shows the ratio by counties of total State of North Dakota farm loans closed at the end of 1934 to assessed farm land values for the same year. Examination of this chart shows that counties in the eastern part of the State have less than 4% of State loans to assessed valuation; centrally located counties carry between 4 and 7.9% of loans to assessed valuation; western counties average 10%; and a group of counties located about the Missouri River (in District One) hold over 12% of loans to assessed valuation. It must be emphasized that this chart includes only loans made by the State of North Dakota; private loans or Federal Government loans are not included (except so far as State loans were later refinanced by the Federal Government). To this extent Chart I does not show the *total* burden of farm loans by counties. The significance of this allocation scheme will be evident in connection with the problem of delinquency.

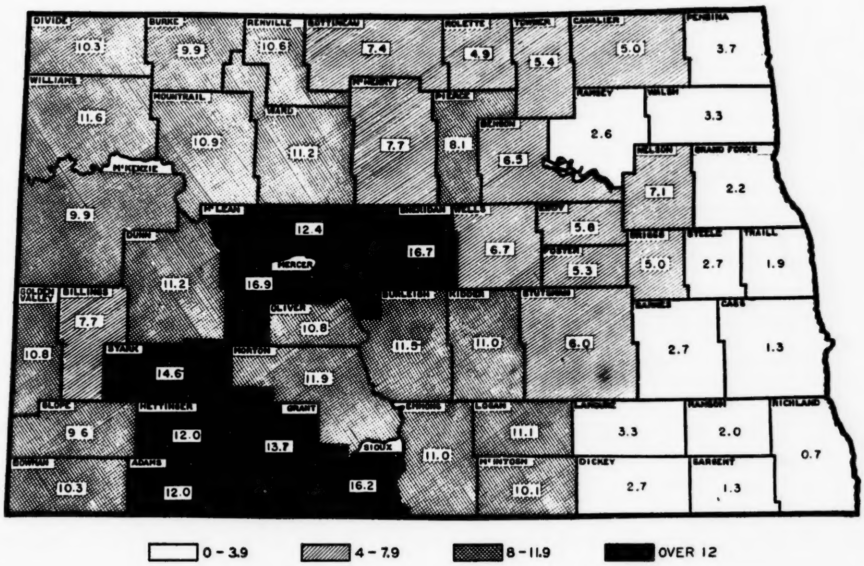
Revenues to operate the closing division of the Farm Loan Department were obtained from a $5.00 fee for each application and an appraisal charge proportionate to the expense incurred. The chief outlay, aside from personnel, was for interest to the Banking Department on money borrowed to meet annual losses. From August, 1919 through 1921 no separate account was kept of the closing division; between January 1, 1922 and January 2, 1934 a deficit of $225,686.68 was incurred. At the latter date the closing division was discontinued and the deficit charged to the collection division of the Farm Loan Department.[20]

[19] Industrial Commission, *Annual Report*, 1922, p. 19.

[20] Industrial Commission, *Annual Report*, 1934, p. 20.

CHART I

RATIO OF TOTAL NORTH DAKOTA FARM LOANS CLOSED AT END OF 1934
TO ASSESSED FARM LAND VALUES, 1934



III. Collection and Delinquency of Loans

From a lender's point of view the success of any farm credit program is measured by the regularity of the amortization charges to cover interest and sinking fund. The following analysis of the delinquency of North Dakota State loans to farmers is to be considered only a rough approximation, inasmuch as (1) the amortization schedule did not follow any strict mathematical system; (2) foreclosures reduced the amount of the open loans and made impossible an accurate study of individual series default; (3) accrued interest on delinquent issues that were still open loans was not given by series regularly. Hence, the accompanying tables present only the general trend.

Under the amortization plan all loans provided for an initial interest charge of 6 or 6½% plus a principal payment of either 1 or 1½%; subsequent payments lowered the proportion for interest and increased the amount for principal. Two conditions should exist with such a plan: (1) the principal payments should increase annually, and (2) the interest payment should cover fixed charges on the bond issue supplying the capital.

Table II represents the condition of the loans at two different periods. The year 1929 is selected because it is a pre-depression year; 1934, because the influence of two severe drought years (1934 and 1936) is not present. Without repeating here the figures of this table, one may point out that exceptionally large foreclosures occurred and were ultimately represented in land owned; that by 1934 only 25% of the remaining open loans were not delinquent in installments; and that the percentage of land owned even in 1929 is significantly high. The table shows also that the older

TABLE II. CONDITION OF NORTH DAKOTA RURAL CREDIT LOANS AT TWO PERIODS:*
September 30, 1929 and October 31, 1934
(Percentage of dollar amounts)

Series and Year†	Amount (000 Omitted)†	Open Loans		Good Standing in 1934§	Being Foreclosed, 1929	Land Owned¶		Refinanced, 1934
		1929	1934			1929	1934	
A-1921	$2,500	42.9%	26.5%	10.4%	7.8%	34.9%	46.4%	13.1%
B-1922	3,000	64.3	29.4	8.5	2.3	14.8	30.0	18.3
C-1922	2,000	70.6	35.3	7.9	1.5	12.7	23.2	22.9
D-1923	3,750	74.5	40.2	8.3	1.4	8.9	22.2	20.2
E-1923	4,109	75.6	38.4	10.1	1.2	8.6	21.4	21.2
F-1924	3,000	82.5	40.9	7.9	—	4.7	18.5	23.1
G-1925	6,000	87.7	44.1	9.5	—	3.3	18.4	24.2
H-1926	4,000	92.2	47.9	10.8	—	2.4	14.3	27.5
I-1929	3,000	84.4	54.0	11.7	—	—	10.0	33.0
J-1929	1,000	—	55.3	11.4	—	—	6.7	33.7
K-1930	2,000	—	68.4	14.6	—	—	1.1	28.6
L-1930	2,000	—	61.4	14.6	—	—	2.7	33.9
M-1931	500	—	73.6	15.1	—	—	—	25.0
N-1931	1,000	—	66.3	13.8	—	—	—	31.4
O-1931	1,000	—	74.3	39.2	—	—	—	22.7
P-1931	714	—	72.0	23.9	—	—	—	26.6
S.A.‡	931.6	—	50.3	9.5	—	—	—	27.8
Total	40,505	79.9	46.0	12.2	1.6	8.3	17.3	24.3

* Board of Auditors, *Report on Bank of North Dakota*, 1929, p. 164; *Ibid.*, 1934, p. 230.
† Year of series and dollar amount of issue relate to bond issues; the exact date and amount of loan series were not available.
‡ S.A. stands for special assessments held by the Banking Department for which no bonds were issued; paid to Bank by state treasurer in 1933.
§ "Good standing" is the label for loans not delinquent.
¶ "Land owned" is the label for face value of loans already foreclosed.

series yielded a much larger percentage of land owned.

In an attempt to get at the true chronological picture of all the loans, the writer has constructed Table III to present the median condition of all series at the end of given years after issuance of the bonds. The main purpose of this table is to show that all series possess a tendency to approach an undesirable condition: at the end of five years approximately 10% of the loans were being foreclosed or in land owned (sheriff's deeds); at 10 years, over 30% was in

TABLE III. CONDITION OF NORTH DAKOTA RURAL CREDIT LOANS AT GIVEN PERIODS*
(Median of the series expressed in per cent)

At End of	Open Loans	In Foreclosure	Resold Land	Sheriff's Deed	Sale Pending	Total Unpaid
1 year	99.00%	.37%	—	—	.07%	99.00%
2 years	98.40	.65	—	.37%	—	98.80
3 years	92.61	2.56	.08%	.80	.28	97.05
4 years	87.72	1.82	.18	2.65	.48	91.55
5 years	81.19	3.20	.43	6.02	.46	84.47
6 years	74.05	2.80	1.11	7.02	.40	87.71
7 years	71.07	2.04	1.63	10.80	.59	85.58
8 years	67.29	2.65	2.57	13.17	.30	84.33
9 years	63.05	3.93	3.55	16.03	2.44	83.13
10 years	61.42	4.85	8.32	19.64	—	82.26

* Calculated by the writer from the original data in the Board of Auditors, *Annual Report on Bank of North Dakota*, 1926–1934. Each of the 16 series was changed from dollars amount to percentage under the above headings; these percentages were arranged in chronological order by years from date of issue; all percentages with the same time sequence were assembled and the median of these groupings obtained. These medians are in the table. Because of this median method "total unpaid" is not the sum of all items in each row.

that status. The evidence is plain that excessive foreclosing took place in each issue, the early as well as the late.

The decrease in regular amortization charges prevented accumulation of the expected sinking fund to redeem the bonds at maturity; on the other hand, the unexpected expansion of the Federal Government's program permitted the refinancing of about 50% of the North Dakota State loans and accumulated a premature sinking fund which had to be used at once or else earn only about 3% interest in regular financial markets. The condition of the real estate loans principal account on December 31, 1936, under these changed conditions, is as follows:[21]

Total loans closed.........		$40,505,450.11
Open loans	$8,395,563.94	
Land owned	8,697,119.04	$17,092,682.98
Federal refinancing..........		18,581,690.57
Amortization principal paid...		4,831,076.56
Total as above............		$40,505,450.11

In summary, at that date 21% of the loans were still open, 21% in land owned, 46% were refinanced by the Federal Government, and 12% had been amortized as originally planned. In the federal refinancing, however, the State of North Dakota took a loss of $1,831,126.45 in principal and thus received credit in cash for only $16,750,564.12. From the total cash principal collections (amortization and federal) $15,451,450.11 of bonds and loans held by the Bank of North Dakota were redeemed, leaving a cash balance in the principal fund of $6,130,190.57.

On this same date, December 31, 1936, "interest accrued and interest discounted on farm loans and lands" totaled $6,106,776.69 and "accrued interest not collected" (on open loans) totaled $1,836,022.21.[22] The first item is the accrued interest on either loans foreclosed or the discounted interest on loans refinanced which discount amounted to $2,868,014.63; the second item is the accrued interest on the $8,395,563.94 of open loans.

As mentioned before, collection of loan interest and management of the land owned are performed by the collection division of the Farm Loan Department. To finance this agency an administration fee of ½ of 1% (see quotation at note 17) was added to all loans after the D series. The chief expense, other than personnel, was the interest on funds borrowed from the Banking Department to cover taxes, insurance, and miscellaneous advances on land owned; on December 31, 1933 this revolving fund, as it was called, reached a maximum of $900,000. Even with this interest expense the collection division almost broke even from its organization January 1, 1923 until December 31, 1932. At the latter date, it had a small deficit of $57,118.87. After that date the income, expense, and operating balance are as shown in Table IV.[23]

A few explanations are needed with this profit and loss account: (1) operating expenses increased because of costs for refinancing and management of land owned; (2) the refund from the Banking Department was an interest overcharge on money loaned for advances; (3) the exceptional income during 1934 and 1935 was from fees charged the Federal Government in refinancing the State loans; (4) interest charged off was due from the state treasurer; (5) the closing division deficit (mentioned before) was absorbed by the collection division; (6) the administration fee which constituted the

[21] Industrial Commission, *Annual Report on Bank of North Dakota*, 1936, pp. 21–39. Various tables in this report show a discrepancy of $3,000 in open loans. The writer has used his discretion above.

[22] *Ibid.*, p. 21.

[23] *Ibid.*, 1933–1936.

TABLE IV. OPERATING DATA, COLLECTION DIVISION, FARM LOAN DEPARTMENT, 1933–1936

	1933	1934	1935	1936
Total income	$ 56,092.97	$541,130.29	$579,163.84	$116,383.73
Operating expense	167,488.62	292,909.33	265,836.19	240,056.59
Operating profit	—	248,220.96	313,327.65	—
Operating loss	111,395.65	—	—	123,672.86
Refund from Bank Dept	109,458.39	—	—	—
Interest charged off	—	64,429.82	—	—
Closing division deficit	—	225,686.68	—	—
Cumulative deficit	59,056.13	100,951.67	212,375.98*	88,703.12*

* Surplus.

chief early income had become negligible by 1936 and thus it appears that future statements will show an operating loss.

IV. Causes for Delinquency of the Rural Credit Loans

It seems desirable at this point to offer some explanation of the serious delinquency of the loans and the resultant foreclosure or refinancing by the Federal Government.

First will be mentioned the decline in the average state yield per bushel of wheat per acre harvested. Wheat constitutes about ½ the cash crop in North Dakota. Whereas the 10-year average yield for 1919–1928 was about 11.1 bushels per acre, the 5-year average for 1929–1934 was only 8.5 bushels.[24] At this writing, data are not at hand for 1934, 1935, and 1936, but the severe droughts of 1934 and 1936 and the rust of 1935 make it appear that the average for these years was still below the 1929–1934 average.

Second in the list of incidents is the serious decline in cash farm income as presented in Table V.

Low-acreage production or low farm prices, or a combination of both, perhaps, has waged havoc with a farm income in North Dakota which normally approximates 200 and 250 million dollars. Loans written on such an income cannot be otherwise than in default when the state income falls to ¼ of normal (or $60,000,000) unless reserve assets have been established to meet such contingencies.

TABLE V. NORTH DAKOTA CASH FARM INCOME FROM CROPS AND LIVESTOCK*
(Thousands of dollars)

Year	Crops	Live-stock	AAA Benefits	Total
1924	$226,758	$53,142	—	$279,900
1925	181,723	68,923	—	250,646
1926	108,151	76,858	—	185,009
1927	183,253	62,466	—	245,719
1928	153,670	68,421	—	222,091
1929	121,746	71,250	—	192,996
1930	71,900	57,284	—	129,184
1931	18,089	42,202	—	60,291
1932	37,950	29,513	—	67,463
1933	42,918	32,409	—	75,327
1934	31,701	29,763	$37,693	99,157
1935	41,662	33,988	17,443	93,093
1936	30,607	51,311	12,379	94,297

* Letters from Ben Kienholz, Bureau of Agricultural Economics, Fargo, N.D.

But it is evident, third, that such stored assets did not exist. Deposits of state banks in North Dakota fell from $123,129,000 in 1919 to $49,451,000 in 1929 and to a low of $15,279,000 in 1933; deposits of national banks in North Dakota fell from $73,884,000 in 1919 to $42,008,000 in 1933. Losses of $108,000,000 in state bank deposits and $30,000,000 in national bank deposits are certain to lessen the capacity of the farmer to pay.

[24] Department of Agricultural Economics, North Dakota Agricultural College, *Basic Data for Farm Planning*, Fargo, N.D. (Jan. 20, 1936.)

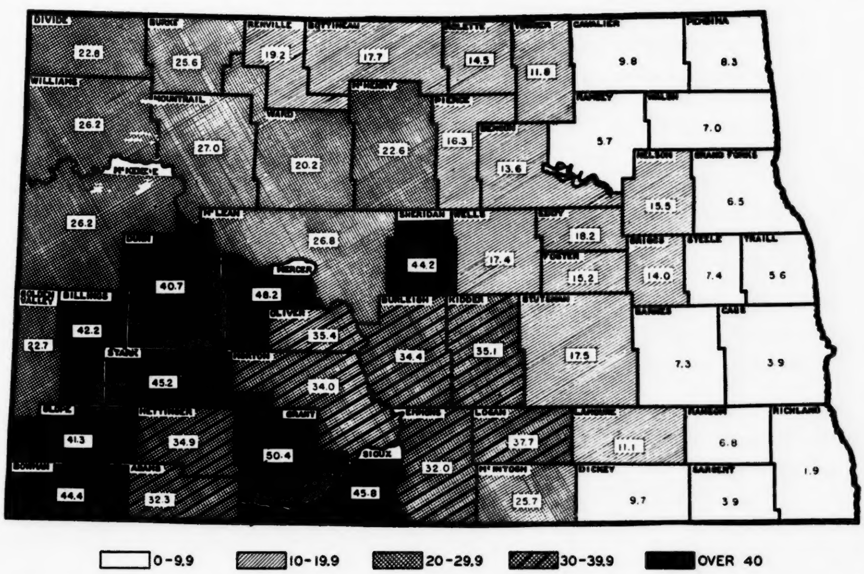
What may be considered the major reason for default on the loans (and possibly a contributing factor in the previously mentioned conditions) is the decline in rainfall. The average rainfall in the eastern half of the State is over 20 inches, in the western half about 16 inches. During the period from 1929 to 1934, however, the eastern average was only 16 inches and the western average fell to 10 and 12. (This is serious because a 10-inch rainfall is considered desert precipitation.)

The above comments are considered explanatory remarks of the general failure, particularly after 1929, to keep up the loan installments. To explain the delinquency before 1929 (as indicated in Table III) one must examine sectional influences. It will be recalled that in allocating the loans, preference was given to farmers in the western counties.[25] Chart I presented the results of that allotment. Chart II presents the ratio of total State of North Dakota farm loans to crop income in each county for three representative years, 1919, 1924, and 1929 averaged. As might be expected, the counties with the highest per cent of loans to assessed valuation (Chart I) also have the highest per cent of loans to income (Chart II). When one considers that the researches by the North Dakota Agricultural College indicate that droughts occurred in the western part of the State in 15 out of the last 45 years, it is difficult to dodge the evidence that farm loans were made in areas least able to carry them. A sectional analysis made by the Board of

[25] Excepting the A series, these loans were closed during a period when the Industrial Commission was controlled by the conservative political faction, called the Independent Voters Association. To that degree, the Non-partisan League forces cannot be blamed for the character of the loans.

CHART II

RATIO OF NORTH DAKOTA FARM LOANS TO CROP INCOME



Auditors (not presented here for lack of space) indicated that as of October, 1934 the borrowers living in the western counties had paid in the least principal, suffered the least foreclosures, and held the most open loans. This paradoxical situation indicates that the western areas were favored in collecting and foreclosing as well as in the original closing. It would appear that areas which suffer a crop loss one year out of three cannot support loans equal to 40 or 50% of the annual income.[26]

V. Condition of North Dakota Real Estate Bonds

The second section of the constitutional amendment authorizing bond issues for rural credit purposes contained the following:[27]

"Every law authorizing a bond issue shall provide for levying an annual tax, or make other provision, sufficient to pay the interest semi-annually, and the principal within thirty years from the passage of such law, and specially appropriate the proceeds of such tax, or of other provisions, to the payment of said principal and interest, and such appropriation shall not be repealed nor the tax or other provision discontinued until such debt, both principal and interest, shall have been paid . . ."

In conforming to these provisions, both the bond acts of 1919 and 1923 contain identical sections stating that the bonds shall mature in not less than 10 nor more than 30 years; that the state treasurer shall pay the interest and principal at maturity; that, if the Real Estate Bond Payment Fund be insufficient to pay the interest and principal, then the State Board of Equalization shall include in the annual levy such a tax as will meet the need. Both laws asserted that the "full faith and credit of the State of North Dakota is pledged for the payment thereof, both principal and interest . . ."[28]

As listed in Table II, the governor and the state treasurer issued 16 series of real estate bonds, lettered alphabetically from A to P, maturing in from 8 to 30 years and so spaced that approximately one million dollars worth matured each year between 1930 and 1960. From July 1, 1921 to January 1, 1931 a total of $39,573,000 bonds were issued. This bond total differs from the loan total by $931,600 which represents loans carried as assets of the Banking Department until redeemed by the state treasurer out of the Bond Payment Fund.[29]

In considering the condition of the real estate bond payment fund, a distinction must be drawn between the interest and the principal requirements. To meet the cash outlay necessary to offset the delinquent interest income of about 8 million dollars, additional revenue had to be raised as follows:[30]

Motor vehicle tax transfers........	$2,941,718.62
Beer revenue transferred..........	1,015,000.00
General tax levy collected.........	4,033,274.70
Total additional revenue as of December 31, 1936............	$7,989,993.32

Corresponding somewhat to a previous statement on loans, there is now presented a balance sheet on the real estate bonds:[31]

[26] The delinquency traced for the State of North Dakota loans is prevalent also in the federal loan program in North Dakota. As of December 31, 1936, 80% of the Land Bank loans in North Dakota were delinquent as compared with only 22.5% for the entire United States, and 83.1% of the Land Bank Commissioner loans in North Dakota were delinquent as compared with only 18.6% for the United States. In both instances, North Dakota had the highest delinquency of any state. (Cf. *Fourth Annual Report*, Farm Credit Administration, 1936, pp. 124, 159.)

[27] Constitution of North Dakota (1918), Art. 31, §182.

[28] Laws of North Dakota, 1919, c. 154; *Ibid.*, 1923, c. 232.

[29] Industrial Commission, *Annual Report*, 1936, p. 38.

[30] *Ibid.*, p. 21.

[31] *Ibid.*, pp. 21, 36.

Total bonds issued	$39,573,000.00
Redeemed by state through refinancing	14,519,000.00
Outstanding on December 31, 1936	$25,054,000.00
Secured by:	
Outstanding loans	$ 8,395,563.94
Real estate owned	8,697,119.04
Cash in fund	6,130,190.57
Total	$23,222,873.55
Deficit (refinancing)	1,831,126.45
Total as above	$25,054,000.00

Inasmuch as the bond maturities through January 1, 1945 total only $6,415,000 and the cash in the principal fund totals $6,130,190.57, there is no immediate concern over the maturity of the bonds. However, to meet the maturity of the remaining 19.4 million dollars there exists only 8.4 million dollars of open loans and 8.7 million dollars of land owned. (The former is now 75% delinquent and the latter is carried on the books at the value of the loan granted.) The total loss to the State in handling the principal amounts to $1,831,126.45 taken on refinancing with the Federal Government and $2,181,444.21 incurred as expenses in foreclosing the farms owned.[32]

A more serious matter is the interest requirements on the outstanding $25,054,000 of bonds. Only 8 of the original 40 million dollars of open loans remain to bring in amortization charges; yet 25 out of 39 million dollars of bonds must still be paid interest. Furthermore, instead of an expected income of about $500,000 annually on these remaining open loans, only $138,548.93 was received in 1936. The difference between this amount and the $1,339,725.64 due on the bonds must be obtained from state revenue, or interest on the principal fund (interest amounts to about $180,000 yearly). Thus it is evident that the state must raise over one million dollars annually to cover real estate bond interest, until such time as the loans discontinue their delinquency and the land owned is either sold or rented on as favorable a basis as if it were earning amortization charges.

On December 31, 1936 the past deficits on interest payments and the deficits on principal totaled as follows:[33]

Interest accrued and interest discounted	$6,106,776.69
Principal of loans and lands discounted	1,831,126.45
Non-ledger deficits in collection division	979,310.92
Sub-total, real estate bond payment fund	8,917,214.06
Surplus in collection division expense account	88,703.12
Total deficit, as of December 31, 1936	$8,828,490.94

Future deficits are likely to approximate the following:

Loss on discounting accrued interest on open loans	$ 1,000,000
Loss on disposal of land owned	1,000,000
Interest to be met by taxes for, say, 10 years	10,000,000
Total loss estimated by writer for the future	$12,000,000

In summary, therefore, one may conclude that the 40 million dollar rural credit program will cost the State of North Dakota about 20 million dollars when completely liquidated. Without considering in this brief article any theoretical aspects of the matter, one cannot help in closing but raise the issue as to whether this experience does not cast doubt upon the propriety of attempting to use credit facilities to equalize unequal economic income. The experiment surely ought to serve as a warning to the Federal Government and to provide a question for economists to discuss as to the best method of solving agricultural problems and of handling marginal producers.

[32] *Ibid.*, pp. 21, 30, 38.

[33] *Ibid.*, footnote 32.

An Object Lesson in Tax Sharing:

The Distribution of Public Utility Tax Revenues to Municipalities in New Jersey*

By DENZEL C. CLINE†

THE sharing of state-administered taxes with local governmental jurisdictions has become a significant feature of state and local fiscal relations in many states. As new sources of revenue have been developed to supplement the property tax, experience has shown that most of these taxes can be administered more effectively by the state. An important aspect of the state-administered, locally-shared tax is the basis of distributing the money and determining the share each local unit shall receive. A variety of bases of distribution are being utilized by the states having the tax-sharing device.

In New Jersey for many years the revenue from the franchise tax and the gross receipts tax paid by certain public utilities has been apportioned by the state tax department to the municipalities or taxing districts (cities, towns, boroughs, and townships) according to the valuation of specified classes of public utility property located in each. The local assessors of the 566 municipalities have been required to report the valuations of such utility property located in their respective taxing districts.[1] The results of this basis of distribution provide an object lesson illustrating how *not* to share taxes with political subdivisions.

Nature of the New Jersey Public Utility Franchise Tax and Gross Receipts Tax

The public utility franchise and gross receipts taxes produced a total revenue of $12,420,833 in 1937 (Table I), while the total taxes levied on general property in the State were $242,987,933. The aggregate yield of the two public utility taxes is now larger than in 1928, when it was $11,805,461. After 1928 it rose to $13,435,652 in 1931; then declined to $11,607,663 in 1934.

Both the franchise tax and the gross receipts tax are levied upon electric, gas, and street railway companies. Telephone, telegraph, water, and sewer companies pay the franchise tax but not the gross receipts tax. Neither of these taxes applies to publicly owned utilities, nor to certain other classes of utilities. Railroads, express and sleeping car companies, and motor bus companies are taxed separately under different laws and are outside the scope of this paper.

Most of the revenue provided by the public utility taxes is contributed by two large companies. The Public Service Electric and Gas Company pays 4/5 of the amount received from electric and gas companies and 2/3 of the total revenue from all utilities. The New Jersey Bell Telephone Company pays 98% of the total from telephone and telegraph companies.

The expenses of the state tax department incurred in administering the franchise and gross receipts taxes, about $25,000 a year, are paid from the revenue produced and the remainder is apportioned among the municipalities. These taxes are not collected by the

* *Editorial Note:* Between the time this article was originally written and its publication here the proposed legislation referred to in the article has been enacted into law by the 1938 Legislature. This fact, however, does not affect the analysis and conclusions of the article.

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[1] Since this paper was written, new legislation has at last been enacted under which the state tax commissioner will make these valuations (Laws 1938, c's 7, 8, 9).

State. After certification of the apportionment by the state tax commissioner, the utility companies pay the taxes directly to municipal tax collectors.

TABLE I. NEW JERSEY PUBLIC UTILITY FRANCHISE AND GROSS RECEIPT TAXES BY CLASSES OF UTILITIES, 1937*

No. of Companies	Class of Utility	Franchise Tax	Gross Receipts Tax
21	Gas and electric...	$5,411,939	$5,170,233
4	Street railway.....	241,564	248,778
15	Telephone and telegraph..........	905,210	—
95	Water...........	408,407	—
7	Sewer...........	34,702	—
142		$7,001,822	$5,419,011

* New Jersey State Tax Department.

The public utility franchise tax, in effect since 1900, is imposed on utilities having tracks, lines, wires, or mains located on public streets and highways.[1a] The tax is 5% of the taxable gross receipts, unless the total receipts are less than $50,000 a year, in which case the rate is 2%. Most of the franchise tax is contributed by utilities paying the 5% rate. The tax applies to such part of the gross receipts from intrastate business from a utility company's lines in New Jersey as the length of its lines occupying public highways bears to the total length of its lines in the State. The franchise tax paid varies, therefore, not only with the amount of gross receipts from intrastate business, but also with the proportion of a utility's lines located on public highways.

The gross receipts tax on electric, gas, and street railway companies is in lieu of the exemption from the property tax of all their property except land and buildings. In addition to the franchise tax, the gross receipts of such utilities from business over their lines in New Jersey during the preceding calendar year are taxable at the average rate of taxation of general property in the State.[2] The average rate has risen from $2.853 per $100 of assessed taxable valuation in 1919, when the gross receipts tax was introduced, to $4.222 in 1937. In 1919 the assessed valuation of the property of electric, gas, and street railway companies exempted from taxation was $70,424,907, while their gross receipts taxed at the average rate were only $60,350,123. It is not known whether these utilities are now paying more or less gross receipts taxes than they would be paying in additional property taxes if they did not have the exemption given by the gross receipts tax law.

A utility subject to both taxes may have considerably smaller taxable gross receipts under the franchise tax than under the gross receipts tax, since, in the case of the latter, receipts that are taxable at the average rate do not depend upon the proportion of the total mileage of lines represented by lines in public streets and highways. Certain receipts, however, are not taxable. Neither tax is paid on receipts from sales to another utility subject to the tax. This is not limited to sales of service to be resold by another utility, but applies to all receipts from other utilities paying the franchise or gross receipts tax.[3] Under both of these taxes only receipts from sales of service over a utility's lines are taxable. Electric and gas companies are not taxed on receipts from sales of refrigerators, stoves, and other merchandise which would be taxable as personal property when in the possession of other merchants.[3a]

The law does not distinguish between

[1a] Laws 1900, c. 195 as amended.

[2] Laws 1919, c. 25.

[3] Laws 1926, c. 142.

[3a] The previous exemption of such merchandise from taxation as personal property was renewed by Laws 1938, c's 7,8.

receipts from intrastate and interstate business and formerly both types were treated as taxable gross receipts in levying both the franchise tax and the gross receipts tax. A decision of the United States Supreme Court in 1930 invalidated the application of the franchise tax to receipts from interstate business.[4] The legality of levying the gross receipts tax on receipts from interstate business has not been decided specifically by the courts, but the state board of tax appeals has ruled that it is illegal.[5]

With the exception of the tax-exempt personal property of electric, gas, and street railway companies, the real and personal property of utilities subject to the franchise tax is taxed at local rates in the taxing districts where it is located, and is assessed for taxation by local assessors. They also report the valuation of tax-exempt public utility property in their respective municipalities and this is added to the valuation of taxable property in determining the amount of state and county property taxes each taxing district must contribute.[5a] The gross receipts tax paid by a utility is apportioned among the municipalities according to the valuation of all its tax-exempt property located in each, while the franchise tax is distributed according to the valuation of a utility's property located on public streets and highways in each municipality.

The Attempt to Secure Uniform Valuations

The method of apportioning public utility taxes has recently become a subject of litigation and controversy but the problem has existed since the State first began distributing the revenue to municipalities with the adoption of the franchise tax law of 1900. An amendment in 1903 attempted to mitigate inequalities by giving state tax officials "the power to inquire into, equalize and revise the valuations . . . of local assessors . . . so as to secure an equitable and fair valuation and apportionment of said franchise tax upon a uniform basis. . . ."[6]

The gross receipts tax law of 1919 provided that assessors' valuations of tax-exempt utility property should be subject to the same inquiry, equalization, and revision as valuations reported for the franchise tax. For many years the revenue was apportioned on the basis of assessors' valuations with little attempt by the state tax department to revise and equalize them. As might have been expected, some assessors discovered that by inflating valuations their municipalities would be apportioned more revenue. This was a matter of indifference to utilities paying the gross receipts tax, since their personal property was tax exempt and the total amount of their taxes was not affected. Under the circumstances, the surprising fact is not that some assessors inflated their valuations, but that many continued to report valuations later found to be below the value of the property.

The state tax department was reorganized in 1931 and placed under a state tax commissioner. A separate board of tax appeals was created with power to hear appeals from action taken by the state tax department.[7] In the same year an appropriation of $25,000 was given the state tax department for a special investigation of the apportionment of public utility franchise and gross receipts taxes.

[4] *Bell Tel. Co. v. N.J. State Board of Taxes and Assessment*, 280 U.S. 338 (1930).

[5] *N.J. Power & Light Co. v. State Tax Commissioner*, N. J. State Board of Tax Appeals, *Report of Cases Decided July 1, 1934 to December 31, 1935*, p. 106.

[5a] Both of these former practices are discontinued by Laws 1938, c's 7, 8, 9.

[6] Laws 1903, c. 142.

[7] Laws 1931, c's. 100, 336.

The tax commissioner engaged a public utility engineer to devise a system by which the department could easily and inexpensively determine uniform valuations and obtain a fair apportionment of utility taxes. After collecting data showing the cost of construction of utility plants and the prices of equipment, the engineer submitted a series of reports giving unit values for the valuation of telephone, street railway, electric, and gas properties for apportionment purposes. These are called the Osgood unit values after the name of the engineer who prepared them. The state tax department used them in fixing valuations until the practice was stopped by a court decision in 1936.

As this decision precipitated a crisis in the apportionment question, the Osgood unit values should be examined, particularly since their use probably will be resumed by the tax commissioner if bills pending (January, 1938) in the Legislature are adopted.[7a] The method of calculation may be illustrated by the unit value established for electric generating plants. From data covering a number of plants it was computed that the average cost of electric generating station property, excluding land and buildings, was $70 per kilowatt of the maximum generating capacity. This figure was reduced to $35 per kilowatt capacity as the unit value with which to calculate the valuation of a generating station for apportionment purposes. Osgood found that the average amount of electricity actually generated represented only 50% of the maximum potential capacity, and from this he concluded that the unit value for apportionment purposes should be half the average cost figure.[8]

This is strange reasoning, but perhaps the reduction of 50% was intended to take account of depreciation and of the fact that taxable property is commonly underassessed by local assessors. A uniform reduction of this kind, however, makes no allowance for differences in the degree of depreciation and obsolescence of utility plants. The fixing of a uniform unit value per kilowatt of capacity for the valuation of all electric generating stations, regardless of their condition, assumes that their value depends only on their generating capacity and varies in direct proportion to the maximum kilowatt capacity. The Osgood unit values are based on the *average* cost of utility property and the *average* ratio of actual to potential generating capacity.

It should be recognized, however, that the unit values were not to be used to determine valuations of utility property for the purpose of taxing it as property, but to provide a fair and uniform basis of apportionment among municipalities of the revenue from public utility taxes. For this purpose the unit-value system of valuation has distinct merits. It eliminates the unfairness resulting from the unequal and often fantastic "valuations" submitted by local assessors; it is easily applied by the state tax department; and is much less expensive than valuations based on actual physical appraisals.

In 1933 and again in 1934 bills were introduced in the Legislature specifically authorizing the state tax department to use unit values in fixing valuations for apportionment of public utility taxes, but these failed of adoption. Believing he had this authority under existing law and that legislation would soon be en-

[7a] The unit-value method is again being used since enactment of the new legislation.

[8] Farley Osgood, *A Study to Develop Unit Cost Basis for the Equitable Division among Individual Taxing Districts of the Gross Tax Received from Electric and Gas Properties*, p. 12. Unpublished report submitted to the N.J. State Tax Commissioner, March 3, 1932.

acted removing any doubt of legality, the state tax commissioner substituted his valuations based on Osgood unit values for those reported by local assessors in apportioning utility taxes in 1933, 1934, and 1935.

The substitution of the new basis of apportionment in 1933 caused marked changes in the amount of utility tax received by most of the municipalities. This was particularly true of the gross receipts tax, a few municipalities receiving much less, and many receiving more than in 1932, since the money lost by some taxing districts was gained by others. The effect of the change in the basis of apportionment is illustrated by the distribution of the gross receipts tax of the Public Service Electric and Gas Company. This Company's gross receipts tax is distributed to some 290 municipalities and in 1933 amounted to $3,476,940. Table II compares for certain municipalities the assessors' valuation of the tax-exempt property of this Company with that of the state tax commissioner; and the amount of gross receipts tax that would have been received on the basis of assessors' unrevised valuations with the amount actually apportioned.

This table reveals the very great inequality in valuations of utility property reported by local assessors and the need for a uniform basis of assessment, if utility taxes are distributed according to valuations. It will be observed that the inequality is the result of varying degrees of both inflation of valuations by some assessors and undervaluation by others. It is interesting that, despite the excessively high valuations of a few municipalities, the total of all valuations of the tax-exempt personal property of the Public Service Electric and Gas Company reported by assessors in 1933 was $144,328,885, a sum not much larger than the total of $138,649,829 fixed by the state tax department.

The Aftermath—Litigation

Municipalities adversely affected promptly brought appeals to set aside the tax commissioner's apportionments

Table II. Effect on Gross Receipts Tax Received from the Public Service Electric and Gas Company by Selected New Jersey Municipalities as Result of Substitution of State Tax Department's Valuations for Local Assessors' Valuations, 1933*

Municipality	Valuation of Company's Tax-Exempt Property		Amount of Gross Receipts Tax	
	As Reported by Local Assessor	As Fixed by State Tax Department	If Apportioned on Assessor's Unrevised Valuations	Apportionment by State Tax Department
Jersey City	$28,743,000	$13,759,144	$692,416	$345,040
Hoboken	3,244,100	1,090,579	78,150	27,349
Bayonne	2,750,000	1,198,240	66,247	30,048
Camden	10,284,301	6,196,894	247,748	155,400
Roseland borough	3,396,600	2,082,483	81,824	52,223
Newark	23,634,000	21,582,127	569,341	541,218
Burlington city	940,000	2,538,619	22,644	63,661
Gloucester city	81,000	414,759	1,951	10,401
Pennsauken township	141,930	638,073	3,419	16,001
Hamilton township (Mercer County)	502,781	2,055,369	12,110	51,543
Princeton borough	95,500	425,482	2,301	10,670
Florham Park	5,300	97,676	128	2,449

* Records of the New Jersey state tax department.

and force him to discontinue the unit-value method. In the Roseland case and a long list of subsequent decisions the state board of tax appeals held that the action of the tax commissioner in disregarding the assessors' valuations was illegal.[9] Believing that the courts would reverse the state board of tax appeals, the tax commissioner continued to use his unit-value basis of apportionment.

Two conflicting decisions were rendered by the State supreme court in 1935, one of which sustained the state tax commissioner, while the other declared his use of the unit-value system illegal. The following significant comments appear in the former opinion:

"The proofs before the board of tax appeals indicate to us that the only evidence as to a fair apportionment disclosed the correctness of the commissioner's action. . . . A scientific basis for appraising a utility's property within the several taxing districts was proved and followed by the tax commissioner. The result was uniform. Such method conforms to the law. . . ."[10]

This view of the legality of the tax commissioner's method of apportionment, however, was not allowed to prevail. Another panel of judges of the supreme court in the West Orange case held illegal the commissioner's action in substituting valuations based on unit values for those submitted by assessors. This decision was affirmed without opinion by the state court of errors and appeals in May, 1936 for the reasons expressed in the opinion of the lower court. The latter had said:

"It appeared from the testimony of the commissioner that his valuation was based entirely upon the so-called 'unit capacity' valuation system evolved by Mr. Osgood. Physical values based upon a direct assessment were disregarded. The reports of the assessors were disregarded. What the commissioner did was not to revise and correct the assessments certified to him in accordance with the direction of the Legislature, but to put them aside completely and adopt a system for which there is no legal authority."[11]

Apparently the outcome of the litigation might have been different if the tax commissioner had shown that he had revised, corrected, and equalized the assessors' valuations (as the law clearly authorizes him to do), and had not admitted that their valuations were completely disregarded. The court did not say that the commissioner could not use unit values as a guide to his judgment in equalizing the valuations of assessors. But this has not been done. Following the decision of the court of errors and appeals, public utility taxes have been apportioned upon the unrevised valuations of assessors, except in certain cases where a different method has been prescribed by the state board of tax appeals.

As a result of the decision, the tax commissioner has been forced to comply with judgments of the state board of tax appeals ordering him to make certain reapportionments. For example, the gross receipts taxes of the Public Service Electric and Gas Company for the years 1933, 1934, and 1935 have been reapportioned in compliance with two judgments obtained by the City of Hoboken.[12] The reapportionment has been highly complicated and was not finally completed until September 20, 1937. One judgment required the gross receipts tax of this Company for 1934 to be reapportioned on the basis of the un-

[9] *Roseland v. State Tax Commissioner*, N. J. State Board of Tax Appeals, *New Jersey Tax Reports*, 1912–1934 (1934), p. 660.

[10] *Long Branch v. State Board of Tax Appeals*, Decision of the N.J. State Supreme Court, October 1, 1935. Not reported.

[11] *West Orange v. State Board of Tax Appeals*, 115 N.J.L. 396 (1935); affirmed 116 N.J.L. 414 (1936).

[12] *Hoboken v. Martin, State Tax Commissioner*, Judgments of the N.J. State Board of Tax Appeals, filed February 5, 1935 and October 27, 1936.

revised valuations of assessors reported for that year. Because of the litigation, this utility had been allowed to pay part of its 1934 gross receipts tax to the state treasurer to be held for distribution to the municipalities after a final decision by the courts. From the sum thus reserved it was easy to pay the new balances due the various municipalities in consequence of the reapportionment.

Since the Company had paid to the municipalities all of the 1933 gross receipts tax, its reapportionment was effected by a recapture device provided in another judgment. When the 1933 tax was finally reapportioned, it was based on the unrevised valuations reported by assessors in 1933.

A peculiar conception of fairness on the part of the state board of tax appeals is reflected in its judgment prescribing the method for reapportioning the 1935 gross receipts tax of the Public Service Electric and Gas Company. Anticipating that the tax commissioner's unit-value method of apportionment might be held illegal by the courts, many municipalities raised their valuations of utility property in 1935. One of the most conspicuous examples was Newark, which boosted its total valuation of tax-exempt utility property from $40,155,000 in 1934 to $75,010,000 in 1935. This meant that municipalities like Hoboken reporting the same valuations in both years would not gain as much if the reapportionment of the 1935 gross receipts tax were also based strictly on assessors' valuations.

The judgment written by Hoboken's attorney and adopted without change by the state board of tax appeals in October, 1936 was an ingenious plan to circumvent this possibility. Instead of ordering a general revision of the valuations reported, the judgment directed the tax commissioner to accept as correct the assessors' valuations of the 72 taxing districts reporting the same valuation of the tax-exempt property of the Public Service Electric and Gas Company in 1935 as in 1934. These included Hoboken, Jersey City, Bayonne, Roseland, and certain other municipalities, whose valuations were excessively high in 1934 compared with those fixed by the state tax department. The commissioner was ordered to inquire into and revise the 1935 valuations reported by the assessors of all the other municipalities sharing the gross receipts tax of this Company. He was directed to subpoena the assessors who had raised their valuations in 1935 to explain their increases. He also was instructed in revising their valuations to determine from the inventories filed by the Company whether there had been additions to its property during the year that would justify the increases.

In compliance with this judgment the state tax department called in the assessors of over 200 taxing districts and spent several months in 1937 conducting hearings on their 1935 valuations. Until these were completed the gross receipts taxes of the Company for 1936 and 1937 could not be apportioned, because the judgment required that the gains or losses of the various municipalities resulting from reapportionment of the 1933 and 1935 gross receipts taxes should be added to or subtracted from their subsequent apportionments. When the reapportionment was at last consummated in September, 1937, many municipalities discovered that their share of gross receipts taxes from the Public Service Electric and Gas Company for 1936 and 1937 was greatly diminished, in some cases to nothing. A few may obtain none for some time to come because the Hoboken judgment requires them to pay back, as deductions from their current

share of the gross receipts tax, all money gained under the tax commissioner's invalidated apportionments.

The franchise taxes of the Public Service Electric and Gas Company apportioned by the unit-value system of valuations have not been required to be reapportioned. The Hoboken judgments were limited to the reapportionment of the gross receipts taxes of this Company. Other judgments of the state board of tax appeals have ordered the reapportionment of both the gross receipts and franchise taxes of certain other utility companies. These reapportionments have been based upon the unrevised valuations of assessors and will not be discussed.

It was the effect of the return to assessors' valuations in the 1937 distribution of the franchise tax that aroused a storm of protest beginning a few months before the final reapportionment of the gross receipts taxes of the Public Service Electric and Gas Company was announced. The 1936 franchise tax was apportioned by the unit-value system of valuations shortly before the decision of the court of errors and appeals invalidating this method. The gross receipts tax of the Company was in litigation and therefore had not been apportioned. In 1937, however, the franchise tax of all utilities was apportioned on assessors' unrevised valuations and most municipalities found their revenue greatly diminished. The effect of the change in the basis of apportionment was accentuated by the fact that certain municipalities had greatly increased their valuations of utility property located in streets and highways. Newark's revenue from the franchise tax jumped from $677,041 in 1936 to $1,568,401 in 1937, and a few other cities, particularly Camden, Jersey City, Hoboken, and Bayonne, received much more from franchise taxes in 1937 than in the preceding year. The booty won by a relatively few municipalities was at the expense of the others, many receiving less than half as much as in 1936.

Demand for New Legislation

This situation resulted in a protest meeting in July, 1937 and the formation of an organization of municipalities to fight for new legislation controlling distribution of public utility taxes. Funds were subscribed to institute legal proceedings to force a reapportionment of the 1937 franchise taxes. The executive committee of the new organization prepared bills which were introduced at a special session of the Legislature. As no action was taken, they were left for consideration by the 1938 Legislature.[13]

The chief feature of the proposed legislation is that the state tax commissioner would be solely responsible for determining all valuations upon which utility taxes are apportioned. The bills declare the franchise and gross receipts taxes to be excise taxes and remove them completely from any connection with the property tax in order to avoid litigation under the "uniform rule" of the Constitution. For this reason tax-exempt personal property of utilities would be eliminated from the valuation base upon which state and county property tax levies are apportioned to taxing districts. The bills as introduced make no changes in the method of taxing public utilities except that merchandise held for resale by electric and gas companies shall be assessed locally and taxed as personal property instead of being tax exempt as formerly.

[13] These bills, with certain minor amendments, became law (Laws 1938, c's 7, 8, 9) despite Governor Moore's vote. The new legislation contains the features of the "proposed bills" referred to in subsequent discussion.

Unlike the bills that failed of adoption in 1934, the proposed bills do not specifically authorize the tax commissioner to establish his valuations with unit values. The method of fixing valuations is left to his discretion. If these bills become law, he probably will resume the practice of calculating valuations with unit values as it is unlikely that sufficient appropriations will be given for physical appraisals of utility property. It was intended that the tax commissioner should have the power to employ the unit-value method if he chooses, but it was considered inexpedient to prescribe the yardstick by which valuations shall be determined.

Since the revenue is still to be distributed according to the value of utility property located in the various tax districts, the bills do not dispense with the troublesome word "valuation." The term is declared to mean "a valuation fixed at a figure determined by the state tax commissioner for the purpose of providing a uniform measure for a fair and equitable apportionment of the excise taxes imposed by this act." It was intended that the commissioner's valuations should be uniform, but not necessarily correspond to "true value" as required for the taxation of property, as their only purpose is to provide a fair apportionment base.

The proposed bills permit any taxing district to appeal to the state board of tax appeals protesting any of the commissioner's valuations affecting its revenue. There is a significant provision, however, declaring that "No such valuation shall be set aside . . . or modified unless it shall be made to appear that such valuation will result in an unfair and inequitable apportionment . . ." This would place the burden of proof on a complaining municipality to show that the commissioner's valuations cause an unfair distribution of the revenue. It would prevent the upsetting of his valuations merely by showing that he had employed a particular method in establishing them.

Nevertheless, the state board of tax appeals and the courts might still find that valuations based on unit values do not result in an equitable apportionment, on the ground that they are not in fact uniform, since they do not take sufficient account of depreciation, obsolescence, and other factors affecting value. The courts could insist that the commissioner's valuations must represent the same percentage of true value to be uniform. Such an interpretation would seriously limit the usefulness of the unit-value method of valuation since it would still be necessary to determine full values, and this probably would require actual physical appraisals. The expense of the latter is not warranted when the purpose of the valuations is merely to provide a base for distributing revenue from taxes on gross receipts.

The difficulty and cost of fixing uniform valuations are practical reasons for abandoning valuations as a basis of apportionment. The revenue could be distributed easily in other ways, such as state aid for schools, which would eliminate the necessity of establishing these valuations for apportionment purposes. Since most of the public utility property concerned is tax exempt anyway, this needless controversy over its valuation is disconcerting especially in view of the nonchalant lack of interest in the serious inequality in assessments of taxable property.

Apportionment Problem Not Solved by Uniform Valuations

The proposed legislation requires the tax commissioner to fix valuations for a fair and equitable apportionment of the

franchise and gross receipts taxes. What is a "fair and equitable" distribution? The answer depends upon the test or standard assumed to measure the fairness of the distribution. One test is uniformity in valuations, but apportionments on uniform valuations may have results that invalidate the assumption that the revenue is distributed in the most equitable manner.

It has been commonly assumed that the *location* of public utility property in a municipality entitles the latter, as a matter of right and justice, to a share of the revenue that is proportional to the valuation of such property within its boundaries. The proposed legislation is based on the same assumption. It would alleviate the present chaotic situation by substituting uniform valuations for those of local assessors. Granting the validity of the primary assumption, there can be no doubt of the desirability of this change. The assumption may be challenged, however, that the revenue should be distributed according to location of utility property. It is widely believed in New Jersey that the state tax department's unit-value method provided a uniform system of valuations and resulted therefore in equitable apportionments. An examination of the finances of certain municipalities will indicate some of the anomalous results of distributing money according to location of utility property, even when valuations are uniform.[14] For this purpose, statistics for 1935, the third year of apportionments on the unit-value basis, will be presented to demonstrate its effect upon four taxing districts.

When local budgets and property tax levies for 1935 were voted, local officials knew the amount of utility taxes apportioned to their respective municipalities in the two preceding years under the unit-value method of apportionment. In approving the 1935 municipal budgets, the state auditor permitted a municipality to anticipate in its budget a sum to be received from public utility taxes that was equal to the amount apportioned in 1934. In general, in determining the size of its 1935 local tax levy a municipality took account of the amount that was being apportioned to it under the unit-value method of valuation. It is true that the legality of this method was being contested, but the issue was not finally settled until more than a year after the property taxes for 1935 had been levied. It would appear, therefore, that statistics for 1935 may be taken as fair evidence to exemplify some of the peculiar fiscal consequences of distributing utility taxes upon what is commonly alleged to be a uniform and equitable basis.

In New Jersey there are separate state, county, local school, and municipal tax levies on taxable real and personal property, but these are combined in setting the tax rate of a municipality and in computing the taxpayer's tax bill. Although the school district is usually coterminous with the boundaries of the municipality, there are separate local levies for schools and for municipal or other local purposes. Fourteen of the 566 municipalities anticipated sufficient revenue from other sources, chiefly from public utility taxes, to cover their budgets in 1935 so that they levied no tax whatever for munici-

[14] For interesting studies in three other states showing the effect of the location of large public utility properties in certain municipalities upon their finances, see the following: Harold M. Groves and George M. Keith, "Some Solved and Unsolved Problems of Public Utility Taxation in Wisconsin," 10 *Journal of Land & Public Utility Economics* 109–19 (May, 1934); Eugene E. Oakes, *Studies in Massachusetts Town Finance* (Cambridge: Harvard University Press, 1937), Chap. VII; Eugene E. Oakes, "The Taxation of Public Utility Property in Vermont," 21 *Bulletin of the National Tax Association* 66–75 (December, 1935).

pal purposes. All 14 had some taxes on property since they had state and county taxes to raise, but three of them also had no local school tax on property.

These three municipalities (Roseland borough, Holland township, Bordentown township) together with a fourth (Lower Penn's Neck township) have been selected for more detailed examination. Although Lower Penn's Neck had a local school tax in 1935, it was able to appropriate $63,000 for its schools from utility revenue as well as cover its municipal budget from the same source. Each of these four municipalities has a relatively small population. They have been chosen because they have such low property taxes as a consequence of the utility property located in them. Roseland and Holland not only have no taxes on property for local school or municipal purposes, but also pay a part of their state and county taxes from public utility revenues.

In 1935 the tax rates on property in the four municipalities ranged from $1.05 to $1.56 per $100 of the assessed taxable valuation, while the average rate for the State as a whole was $3.98. Bordentown township has had a low tax

Table III. Revenue from Public Utility Gross Receipts and Franchise Taxes Compared with Property Taxes in Four New Jersey Municipalities, 1935 and 1928*

	Roseland Borough	Holland Township	Lower Penn's Neck Township	Bordentown Township
Property Taxes:				
Tax rate per $100 assessed taxable valuation				
1935	$1.05	$1.32	$1.39	$1.56
1928	4.57	4.69	2.16	1.85
Local school and municipal taxes (excluding state and county)				
1935	0	0	24,500	0
1928	45,007	23,316	74,813	0
Total taxes on general property				
1935	19,322†	14,230†	177,085	11,187
1928	56,790	44,998	218,411	12,404
Net assessed taxable valuation				
1935	1,855,849	1,078,032	12,781,853	729,127
1928	1,243,879	961,484	10,091,625	652,649
State Apportioned Public Utility Taxes:				
Total anticipated in local budget				
1935	55,000	25,150	99,190	13,000
1928	1,900	3,125	6,500	14,000
Amount apportioned:‡				
1935				
Gross receipts tax	52,438	46,370	123,896	4,113
Franchise tax	3,517	452	2,856	12,282
Total	55,955	46,822	126,752	16,395
1928				
Gross receipts tax	465	135	2,979	2,812
Franchise tax	1,690	281	2,514	13,978
Total	2,155	416	5,493	16,790
Total public utility taxes apportioned per capita:				
1935	52.89	47.10	43.22	20.04
1928	2.03	.42	1.87	20.53
Population, 1930	1,058	994	2,933	818

* New Jersey State Tax Department, *Annual Reports*, 1935, 1928; and records of the state tax department and the state auditor.

† In 1935 Roseland's state and county taxes were $38,989 and those of Holland township were $24,194. The difference between the amount required to be paid as state and county taxes and the total sum actually levied on property was paid from public utility tax revenue.

‡ All figures for public utility taxes apportioned in 1935 indicate apportionments based on the tax commissioner's uniform system of valuations. The 1928 apportionments were based on assessors' valuations.

rate for many years but the other three municipalities have been favored only recently by their selection as locations for large electric plants. In 1928, before these plants were built, the tax rate was \$4.57 in Roseland, \$4.69 in Holland, and \$2.16 in Lower Penn's Neck, while the average tax rate for the State was \$3.88. Table III indicates the marked difference in the tax rates of these municipalities in 1935 and 1928. The total 1935 assessed valuation of the taxable property in the State was slightly less than in 1928 but in each of these municipalities there was an increase in assessed valuation. This increase was at least partly the result of construction of electric plants, since the land and buildings of such utilities are taxable. It is evident from the table, however, that the most significant reason for the drop in tax rates, especially in Roseland and Holland, is the decline in total taxes on general property. In these two municipalities the local taxes for school and municipal purposes fell to zero, and in Lower Penn's Neck were only a third as large in 1935 as in 1928. The reason for this was the remarkable increase in utility taxes apportioned to them.

With the exception of Roseland, the tax rates in 1935 might have been even lower than they were because less revenue from utility taxes was anticipated in the budget than was actually apportioned. For example, Holland anticipated receiving \$25,150, while the total amount apportioned was \$46,822. If the larger sum had been anticipated in the budget, Holland need have had no taxes whatever on property in 1935, since only \$14,230 was raised from the property tax. The total utility revenue apportioned to each of the municipalities, except Lower Penn's Neck, was greater in 1935 than the total taxes on property.

A comparison of the per-capita amount of utility tax revenue apportioned in 1928 and 1935 to Roseland, Holland, and Lower Penn's Neck vividly portrays in another way the bonanza that has recently befallen them. In contrast to the per-capita figures shown in Table III, the total amount of revenue per capita apportioned from the public utility franchise and gross receipts taxes for the State as a whole was \$2.92 in 1928 and \$2.94 in 1935.

Roseland borough is in the northern New Jersey metropolitan area. Most of its utility revenue is derived from the gross receipts tax, as a result of the location there of a large electric switching station of the Public Service Electric and Gas Company. The state tax department's valuation of the tax-exempt utility property in Roseland in 1935 was \$2,088,084, while the local assessor reported its value at \$3,396,600. The gross receipts tax apportioned on the tax commissioner's valuation was \$52,438, but upon reapportionment under the Hoboken judgment Roseland received \$76,780. The recent low taxes on property have been reflected in rising real estate values.

Holland township is in the northwestern part of the State and is the site of an electric generating plant of the New Jersey Power and Light Company. The state tax department's valuation of the tax-exempt personal property of the Company in Holland was \$2,954,631 in 1935, while that of the local assessor was \$1,202,410. The gross receipts tax first apportioned to this township for 1935 was \$53,638 but the apportionment, on the same valuation of the state tax department, was reduced to \$46,370. This was a result of an order by the state board of tax appeals remitting to the New Jersey Power and Light Company that part of its gross receipts tax that

was levied on receipts from interstate business. When the 1935 tax of this Company was reapportioned on the basis of assessors' valuations in accordance with a judgment of the state board of tax appeals, Holland's share of the gross receipts tax was further reduced to $32,443.

The reduction in property taxes following erection of the electric plant in Holland has benefited not only the farmers of the township but also a corporation owning paper mills there. The property of the paper company represents more than 1/3 of the total assessed valuation of the taxable property of the township. The taxes on the real and personal property of this company, together with those on the land and buildings of the electric company, provide over 1/2 the total taxes on property in Holland. The two corporations are thus the chief beneficiaries of the very low tax rate.

Lower Penn's Neck township is in the southern part of the State. It receives most of its utility revenue from the gross receipts tax, as the result of the location there of a large electric generating plant, a switching station, and a substation. The output of the generating plant is taken by the Atlantic City Electric Company and the Deepwater Light and Power Company. All of the gross receipts tax of the latter Company is paid to Lower Penn's Neck. The state board of tax appeals has not ordered a reapportionment of the 1935 taxes of the Atlantic City Electric Company. In 1935 Lower Penn's Neck received $42,660 from this Company, while its total revenue from the gross receipts tax was $123,896. In contrast, in 1937 with the apportionment based on assessors' valuations, this township obtained $70,771 as gross receipts tax from the Atlantic City Electric Company and a total revenue from the gross receipts tax of $159,243. Lower Penn's Neck, like Roseland, has materially benefited through the return to assessors' valuations as the basis of apportionment of taxes.

Bordentown township is in the central part of the State, a few miles from Trenton. Unlike the other three municipalities examined, which derive most of their utility revenue from the gross receipts tax, Bordentown township in 1935 was apportioned 3/4 of its utility revenue from the franchise tax under the state tax department's system of valuation. Most of the utility property located in this township consists of electric lines and gas mains of the Public Service Electric and Gas Company located on public highways. The township has approximately 23 miles of electric pole line, and about 5 miles of gas mains, including 3 miles of 12-inch pipe. Because of the distribution lines passing through Bordentown township, it long has received sufficient revenue from utility taxes to have low taxes on property. Since 1915 the tax rate has been between $1.02 and $1.85 and in only four years has this municipality found it necessary to levy any local taxes whatever on property. The custom has been to meet the township budget and make an appropriation to the school district from utility revenues, thus leaving state and county levies as the only taxes on property.

Like Holland, Bordentown township has suffered a reduction in its public utility revenue as a result of the invalidation of the unit-value method of apportionment. Bordentown township was apportioned only $3,604 as franchise tax in 1937, whereas it received $12,282 from this source in 1935 under the state tax department's system of valuations.

It might be expected that "easy

money" from the State would lead to extravagant local spending policies. In Roseland and Holland, however, their augmented revenue from utility taxes between 1928 and 1935 resulted in reduced property taxes rather than increased spending. In fact, in addition to levying no taxes for local purposes in 1935, Roseland took $19,667 and Holland $10,000 from utility revenue to pay part of their state and county tax levies. Although there was a notable reduction in the property tax in Lower Penn's Neck, nevertheless its local expenditures soared from $121,160 in 1928 to $312,974 in 1935 as shown in Table IV.

None of the four municipalities has a high school, and Bordentown township has no elementary school. Tuition is paid for pupils attending school in other school districts. Unlike the relatively slight change in the other three municipalities, the number of school pupils in Lower Penn's Neck rose from 729 in 1928 to 961 in 1935. In recent years this municipality has added to its school buildings and in effect is paying for them with public utility revenues. Capital outlays for schools in 1935 were $65,199, while the township appropriated $63,000 to its school district from utility tax revenues after covering its own budget from this source.

In addition to public utility revenue apportioned by the State to these municipalities, their school districts receive state-aid funds distributed by the state commissioner of education. In New Jersey about 4/5 of the state aid to schools is derived from the state school tax. This tax provides over 95% of the total revenue from the state levies on general property. It is a tax of 2¾ mills per dollar, not of the assessed valuation of taxable property, but of a valuation that also includes the local assessors' valuation of the tax-exempt personal property of utilities subject to the gross receipts tax.

In Table V the state school tax paid by each of the four municipalities is compared with the state aid apportioned to its school district in 1935. The state aid granted to a municipality is in no way related to the revenue received from public utility taxes, but the state school

TABLE IV. LOCAL EXPENDITURES OF THE SELECTED MUNICIPALITIES, 1935, 1928*

	Roseland Borough	Holland Township	Lower Penn's Neck Township	Bordentown Township
Local Expenditures†				
1935				
Municipal	$11,759	$17,745	$133,544	$14,023
School district	39,780	17,795	179,430	16,865
Total	$51,539	$35,540	$312,974	$30,888
1928				
Municipal	18,003	16,762	44,261	8,407
School district	36,266	14,844	76,899	14,289
Total	54,269	31,606	121,160	22,696
Local Debt, Dec. 31, 1936				
Municipal	40,000	11,813	10,500	0
School district	54,200	0	125,000	0
Total	94,200	11,813	135,500	0

* Records of the New Jersey state auditor and the state department of education

† Municipal expenditures do not include payment of state and county taxes or appropriations to school districts. School expenditures include state-aid funds and public utility money appropriated to the school district by the municipality.

TABLE V. STATE AID FOR SCHOOLS APPORTIONED TO THE SELECTED MUNICIPALITIES IN ADDITION TO REVENUE FROM PUBLIC UTILITY TAXES, 1935*

	Roseland Borough	Holland Township	Lower Penn's Neck Township	Bordentown Township
State school tax contributed by municipality	$13,378	$ 6,112	$ 50,890	$2,346
Total state aid apportioned to school district	10,073	7,846	24,875	8,295
Revenue apportioned from public utility taxes, plus state aid for schools	66,028	54,216	151,627	24,690
Total state, county, and local tax levies	38,989	24,194	177,085	11,187
Ratio of revenue from public utility taxes plus state aid for schools to total tax levies	179%	224%	86%	221%

* Records of the New Jersey state tax department and the state department of education.

tax to be contributed is affected by the amount of its tax-exempt utility property. The fortunate position of these local units is further emphasized by comparing the combined revenue from utility taxes and state aid for education with the total taxes raised. The latter includes all taxes on property and, in the case of Roseland and Holland, state and county taxes paid from public utility revenue. In contrast to the high ratios shown in Table V, for the State as a whole the sum of all state aid to school districts plus the total amount distributed from utility taxes was equal to only 13.2% of the total taxes on general property.

To this point the analysis has indicated the effect of apportionment of utility taxes by the state tax commissioner under a uniform system of valuations. The bills now under consideration by the Legislature[15] not only give the state tax department the duty of determining all valuations upon which utility taxes are apportioned, but also eliminate tax-exempt utility property from the valuation base upon which state and county property taxes are apportioned. It is also provided that the state school tax shall be 2.9 mills per dollar of assessed taxable valuation, instead of a levy of 2.75 mills on a valuation including tax-exempt public utility property. With this change, the aggregate yield of the state school tax in 1938 would be practically the same as under the existing law.

These proposed changes would result in a further gift to taxing districts having relatively large amounts of tax-exempt utility property. The tax rates that would have existed and the state and county taxes that would have been contributed in 1935 by the four municipalities, had this plan been in effect, have been computed. These are compared in Table VI with the actual tax rates and state and county taxes paid in the same year. In computing the hypothetical tax rates, it has been assumed that the diminution in state and county taxes would have been reflected in a similar reduction in the total taxes on property. With this assumption, Roseland not only would have had no taxes on property in 1935, but would have had $4,815 more for local spending than it did. Holland's tax rate would have been only 22 cents per $100, assuming that the property tax would have been reduced only by the lessened amount of state and county taxes. But Holland also could have had no taxes on property and an even larger surplus for local expenditures, since this township had greatly underestimated its utility revenue when setting its 1935 tax rate.

[15] See n. 13 above.

The proposed method for apportioning state and county levies, therefore, means that such municipalities more than ever can be "taxpayers' paradises" if utility taxes continue to be distributed according to the location of utility property. Nevertheless, if public utility revenues are distributed in a manner that will more nearly benefit all people of the State, as will be suggested, tax-exempt utility property should be excluded in the apportionment of state and county tax levies.

Attention has been focussed on four small municipalities to show the peculiar effect, even when valuations are made on a uniform basis by the state tax department, of distributing the revenue from the gross receipts and franchise taxes according to the location of certain classes of utility property. It also has been shown that, if tax-exempt public utility property is disregarded in the apportionment of state and county property taxes to be raised by taxing districts, the result will be even more disconcerting. It seems evident that the "solution" of the problem of the inequitable distribution of utility taxes that is being pressed for adoption will give such municipalities an undue share of the revenue at the expense of other taxing districts not so fortunate.

It must not be assumed, however, that the few taxing districts having unusually low tax rates because of money derived from utility taxes are the only ones that get a disproportionate share of the revenue. Although not so evident, the lack of equity in a distribution according to the location of utility property is fundamentally the same, for example, in the case of a city with a fairly high tax rate that has a large electric or gas generating station and consequently obtains a much greater portion of the gross receipts tax than other municipalities served by the same plant. If it can be assumed that the tax is included in the price charged to users of the utility's service, the consumers in these other municipalities may be bearing most of the burden of the tax, while a major part of the revenue goes to the city where the generating plant is located. In these municipalities the people may support their local government services almost entirely from property taxes and, in addition, pay a tax hidden in their electric and gas bills which in effect lightens the property tax in the particular city where the generating plant is located. The fact that this city may raise perhaps many times more from the property tax than it re-

TABLE VI. HOW PROPOSAL TO ELIMINATE TAX-EXEMPT PUBLIC UTILITY PROPERTY FROM VALUATION ON WHICH STATE AND COUNTY TAXES ARE APPORTIONED WOULD HAVE AFFECTED THE SELECTED MUNICIPALITIES IN 1935

	Roseland Borough	Holland Township	Lower Penn's Neck Township	Bordentown Township
Valuation for apportionment of state and county taxes:				
Actual	$5,251,249	$2,280,342	$18,972,000	$817,654
Under proposed law*	1,854,649	1,077,932	12,775,500	729,127
Total state and county levies paid by municipality:				
Actual	38,989	24,194	152,585	11,187
Under proposed law	14,852	12,288	119,920	8,728
Tax rate per $100 taxable valuation:				
Actual	1.05	1.32	1.39	1.56
Under proposed law	0	.22	1.13	1.20

* The difference between the two valuations is the local assessors' valuation of tax-exempt personal property of public utilities.

ceives from the state in utility taxes is no proof that it is not getting a disproportionately large share of the revenue from the latter.

To illustrate, let us compare two cities in Hudson county near Jersey City. The 1930 population of Kearny was 40,716; total taxes on property in 1935 were $3,146,485; and the tax rate was $4.11 per $100 taxable valuation. Union City had a population in 1930 of 58,659; its total property taxes in 1935 were $3,188,777; and its tax rate was $4.72. Because a large electric generating plant is located in Kearny, this municipality was apportioned $349,522 from the gross receipts tax of the Public Service Electric and Gas Company in 1935 under the state tax commissioner's unit-value basis of apportionment. In contrast, Union City, which has a population more than 1/3 larger and is served by the same Company, received only $18,358 from the latter's gross receipts tax. The inequality indicated by this example is essentially the same as that illustrated by Roseland or Holland. The difference is merely one of degree.

A Suggestion

Instead of directly distributing the revenue from the gross receipts and franchise taxes according to the valuation of utility property located in a municipality, a better plan would be for the state to use this revenue as state aid to schools. If this were done, the state school tax on property, amounting in 1937 to $16,167,709, could be reduced by more than $12,000,000 a year. This change would eliminate the problem of fixing "fair" valuations of utility property for the purpose of distributing the revenue, thereby reducing the cost of administration of the taxes and also the "cost of compliance" to the utility companies. Furthermore, the revenue would be distributed upon a basis that would take some account of a municipality's relative need for state tax funds, and that would avoid the present situation which gives a taxing district a windfall because of the fortuitous location of public utility property within its borders. A municipality would still tax the land and buildings of those utilities subject to the gross receipts tax and the real and personal property of other utilities within its limits.

The greater equity of the method here proposed for sharing the revenue from public utility taxes has long been recognized in New Jersey in the case of the state railroad tax. The lines, tangible personal property, and the franchise of railroads are assessed by the state tax department and taxed at the average rate on general property in the State. The revenue from this tax is not returned to the taxing districts in which the property is located. The greater part is retained by the State and is spent principally for education, but that which is distributed is given as state aid to school districts. There is no indication that the people of this State think it would be an equitable method of tax sharing if a municipality could obtain a large slice of state railroad tax revenue merely because a railroad line happens to be located within it.

Mortgage Law and Mortgage Lending*

By HORACE RUSSELL† *and* DAVID A. BRIDEWELL‡

I. The Problem—New and Old

THE raising of the FHA mortgage insurance limit on homes costing $6,000 or less from 80 to 90% of the value of the property, as provided for by the National Housing Act Amendments of 1938,[1] brings into focus more clearly than ever before the necessity of revising the mortgage and foreclosure laws of many states on a more economical basis.

By thus raising the mortgage insurance limit, the minimum down-payment required of a prospective home-owner on a home costing less than that amount is reduced to 10% of the cost of a property, which in some states would be less than the cost of foreclosure and the cost of the delay to the lender in obtaining title to the property. In other words, this initial down-payment would not be sufficient in such states to cancel out these costs in the event of a default and the necessity to foreclose soon after the loan was made.

Likewise, liberalization of Title III of the National Housing Act of 1934, so as to make the organization of national mortgage associations more attractive and their securities more salable, as provided for by the National Housing Act Amendments of 1938,[2] makes more imperative than ever before the revision of mortgage and foreclosure laws along more uniform lines. Obviously, the more uniform, simple, inexpensive, and expeditious are the mortgage and foreclosure laws of the various states, the easier it will be for such associations to function smoothly and transact their business of making, buying, and selling mortgage loans on a nation-wide basis.

This is not the first time that existing mortgage and foreclosure laws have been viewed as an impediment to mortgage lending. In fact, it has long been recognized by students of the problem that the costly, time-consuming, and often unnecessary procedures required under many state mortgage and foreclosure laws have hampered private mortgage lending and increased the operating expenses of such institutions. Likewise, it has been recognized that these procedures have imposed an actual burden on borrowers by forcing private lenders to charge higher interest rates and lend a smaller amount on the security of properties than had they been operating under more inexpensive, expeditious, and equitable laws. A final result of these uneconomic statutes has been to impede the flow of mortgage money across state lines, thereby indirectly allowing high interest rates to remain in effect in states where demand for such money was greater than supply and, conversely, low interest rates in states where supply exceeded demand.

Such costly, time-consuming, and unnecessary mortgage and forclosure procedures are a bitter paradox, since they benefit neither mortgagor nor mortgagee and can from no standpoint be justified as necessary.

The National Conference of Commissioners on Uniform State Laws, after making a careful study of all state mortgage and foreclosure laws, as well as the

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[1] Sec. 3, Public No. 424, 75th Cong., S. 3055, approved February 3, 1938; 12 U. S. C. 1709.

[2] Sec. 4, *Ibid.;* 12 U. S. C. 1716.

pertinent court decisions, abandoned its early efforts to draft a Uniform Mortgage Act because of the apparent impossibility of drawing a semblance of uniformity out of the complicated procedures in the various states.[3] However, in 1927 the Commissioners on Uniform State Laws succeeded in drafting an Act which was approved later in the same year by the American Bar Association.[4] Despite other influential endorsements,[5] no state has yet adopted this Act.[6]

The participation during the past six years of the federal housing-finance agencies[7] in the field of mortgage lending on a nation-wide basis, with their emphasis on long-term, amortized, single-mortgage lending, brought to the attention of federal officials more clearly than ever before the need of uniform, corrective legislation. Consequently, one of the first tasks assigned by the Central Housing Committee[8] to its Subcommittee on Law and Legislation[9] was the study of the mortgage and foreclosure laws of the various states with a view to obtaining amendments which would provide for a more simple, uniform, inexpensive, and expeditious procedure, facilitate long-term amortized, single-mortgage lending, and be adequate to meet emergencies arising during depression periods.

The Subcommittee, after making an intensive study of the several state laws, decided that it would be better to recommend enactment of a uniform statute rather than amendments to existing state laws. After an intensive study of the Uniform Act of the National Conference of Commissioners, the conclusion was reached that it was not drafted to facilitate long-term, amortized, single-mortgage lending or to meet depression conditions. The Subcommittee, therefore, decided to prepare a new act rather than give qualified approval to the old draft.

Two years were spent in this task. A tentative draft, approved August 31, 1937, was submitted to over 800 authori-

[3] See 36 A.B.A. Rep. 950 (1911); 1920 Handbook of Commissioners on Uniform State Laws 165.

[4] 52 A.B.A. Rep. 402 (1927).

[5] The idea in principle of this Uniform Act met with the general approval of the American Title Association, the National Association of Real Estate Boards, the Association of Life Insurance Counsel, and counsel for Federal and Joint Stock Land Banks as well as of the professors of mortgage law and the deans of the leading schools. See introductory statement which appears in the pamphlet entitled "Uniform Real Estate Mortgage Act." Also see Pomeroy, "The Uniform Mortgage Act," 34 *Journal of Political Economy* 383, 386 (1926); MacChesney, *Principles of Real Estate Law* (New York: Macmillan, 1927), §491; Legis., 27 *Columbia Law Review* 861 (1927); 38 *Harvard Law Review* 651 (1925); 15 *Kentucky Law Journal* 22 (1926); 17 *Virginia Law Review* 179 (1930).

[6] Only Sec. 36, providing for a uniform short-form mortgage, has been enacted in Minnesota (Minn. Stats. (Mason Supp., 1936), §§8204-9).

[7] Federal agencies which make or have made real estate mortgage loans during the past five years are the Home Owners' Loan Corporation, Reconstruction Finance Corporation, Federal Land Banks, and Farm Security Administration (formerly Resettlement Administration). Federal agencies, in addition to these, which are vitally interested in real estate mortgage lending are the Federal Home Loan Bank Board, Federal Savings and Loan Insurance Corporation, Federal Housing Administration, RFC Mortgage Company, and Farm Credit Administration.

[8] The Central Housing Committee is composed of the highest executive officers of the federal agencies concerned with housing finance and construction.

[9] The Subcommittee is composed of General Counsel to federal housing agencies and their alternates. The membership includes: Abner Ferguson (Chairman), Burton C. Bovard, FHA; James L. Dougherty (Vice-Chairman), Paul C. Akin, RFC Mortgage Co.; Peyton R. Evans, H. J. Slaughter (Vice-Chairman), FCA; Leon H. Keyserling, David L. Krooth, USHA; Monroe Oppenheimer, Albert H. Cotton, FSA; A. E. Denton, John J. O'Brien, Dept. of Justice. Horace Russell, former General Counsel, FHLBB, and David A. Bridewell, his legal assistant, who formerly represented the FHLBB on the Subcommittee, served as chairman and secretary respectively from December, 1935, when the Subcommittee was organized, until June and August, 1938 when they resigned. Their FHLBB successors on the Subcommittee have not yet been designated.

ties and agencies[10] interested in mortgage finance. In the light of comments and suggestions received from these sources, the act was finally revised on May 14, 1938.

The purpose of this article is to analyze the unnecessary procedures and useless expenses arising out of existing mortgage and foreclosure laws of many states, to point out how these laws affect both public and private mortgage lending and are at least one of a number of factors which will probably prevent complete realization of the new federal private housing-credit program, to analyze the Uniform Mortgage Act drafted by the Subcommittee on Law and Legislation, and to indicate how general adoption of this act would improve the situation.

II. Diversity in Mortgage and Foreclosure Law

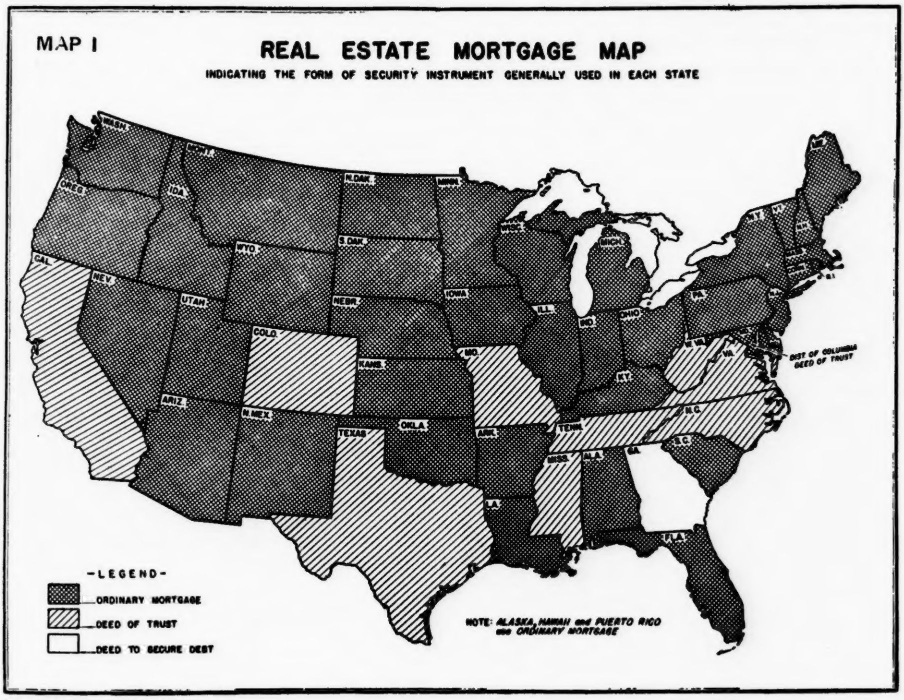
Maps I, II, and III[11] illustrate better than any explanation the existing diversity in the more important aspects of the mortgage and foreclosure laws of the several states.[12] Map I, showing the

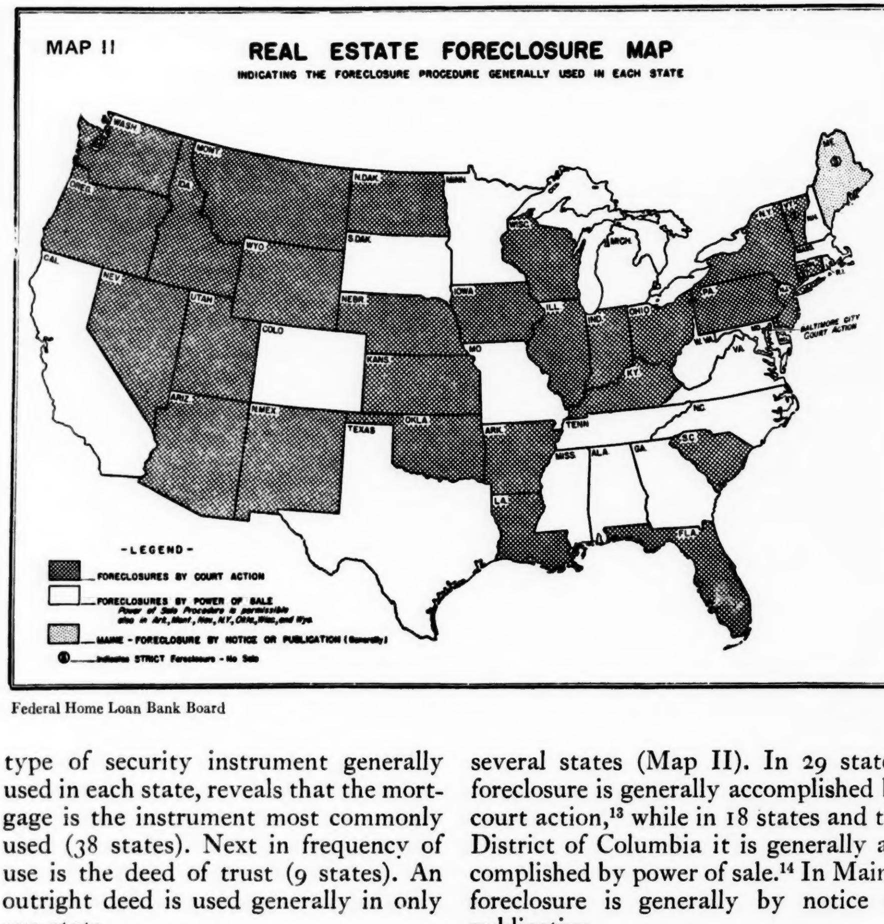
[10] The Central Housing Committee, National Conference of Commissioners on Uniform State Laws, American Bar Association, the United States Building and Loan League, federal and private mortgage-lending institutions, and insurance companies and savings banks interested in mortgage lending.

[11] These maps were prepared by Heber H. Rice, Head Attorney, Foreclosure Section, Litigation Division, Legal Department, HOLC; Harold A. Lamberton, Division of Research and Statistics, FHLBB; and David A. Bridewell, HOLC.

[12] One of the most striking examples of this diversity is found in Kansas City, Missouri and Kansas City, Kansas. In the former, foreclosure is effected by an exercise of the power of sale contained in the mortgage after three-weeks' notice by publication in a newspaper. A deed to the property is immediately given to the pur-

(*Footnote 12 continued on page 304*)





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type of security instrument generally used in each state, reveals that the mortgage is the instrument most commonly used (38 states). Next in frequency of use is the deed of trust (9 states). An outright deed is used generally in only one state.

Similar diversity characterizes the type of foreclosure action in use in the several states (Map II). In 29 states, foreclosure is generally accomplished by court action,[13] while in 18 states and the District of Columbia it is generally accomplished by power of sale.[14] In Maine, foreclosure is generally by notice or publication.

Finally, Map III reveals that the length of redemption periods varies widely from state to state;[15] i.e., from 24

(*Footnote 12 continued from page 303*)

chaser at the sale, as there is no redemption period unless the mortgagor gives notice that he wishes to exercise such right at the sale and guarantees the purchaser against loss by posting bond, in which event the mortgagor has one year in which to redeem. The total cost of foreclosure under this procedure averages about $40.00. On the other hand, in Kansas City, Kansas, there is no provision for power of sale. The action must take place in court and the mortgagor is allowed 18 months after the sale to redeem the property, or 6 months if a purchase money mortgage was given or the property has been abandoned. The total cost of this action is approximately $100.00. However, a comparison of these two cities is striking only because they are so close together. Variations in cost and in time required to complete a foreclosure action in other states are much greater than these.

[13] In 12 of these states, foreclosure by action or suit is required by statute, while in the remaining 17, though not required by statute, this is the method usually followed.

[14] In 11 of these states, no period of redemption follows the sale, while in 7 there is such period.

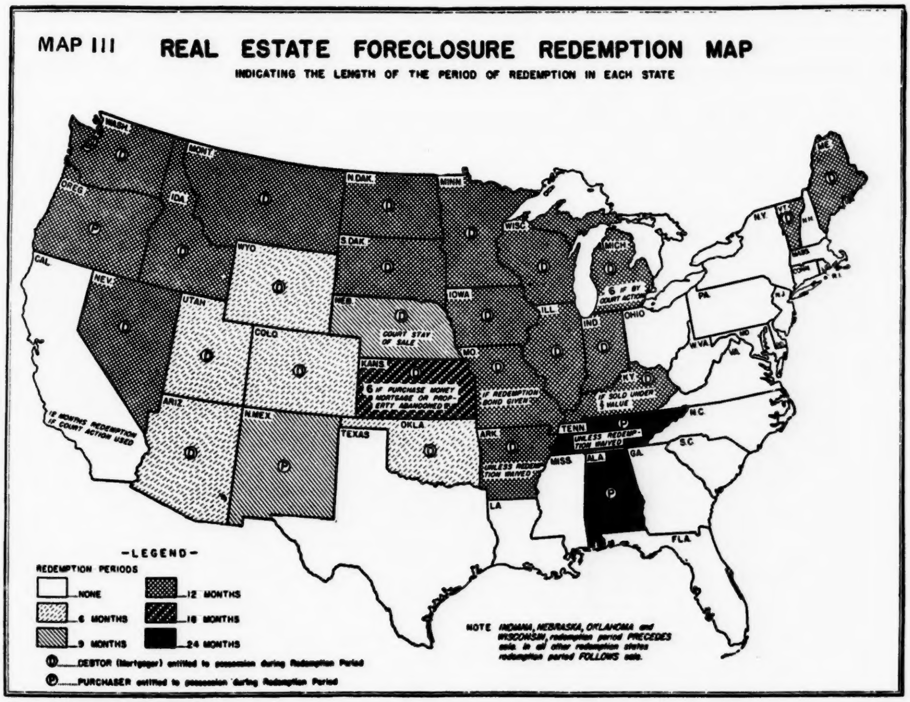
[15] The redemption period shown in this map is that allowed the mortgagor. Some states also allow junior and mechanic lienors and judgment creditors an additional period in which they may redeem, e.g., Illinois, 3 months; Wyoming, 9 months.

months in Alabama to six months in Arizona, Colorado, Oklahoma, Utah, and Wyoming.[16] In 20 states, no redemption whatsoever is provided. Furthermore, in three states (Indiana, Nebraska, Wisconsin) the period of redemption precedes sale of the property, while in the remaining states it starts after the date of sale. Map III also shows that four of the states which provide a redemption period permit the purchaser at the foreclosure sale to take possession of the property during the redemption period, while in the remaining 24 states in this group the mortgagor retains possession of the property during the redemption period.

It was impossible to bring out in these maps the many other variations in the substantive law of mortgages and foreclosure which affect mortgage lending; e.g., the interest created by a mortgage and the period of limitations. Nor was it possible to show the extent of, and diversity in, the emergency moratoria legislation passed during the depression, some of which is still in effect or has been reenacted.[17]

[16] Many of the specified redemption periods are made contingent upon certain conditions, such as waivers, abandonment of the property, sale of the property, and kind of foreclosure action involved.

[17] This legislation may be classified as follows: (1) laws prohibiting foreclosures and sales thereunder until a certain date or for a reasonable time in the discretion of the courts; (2) laws extending the period of redemption on mortgages in process of foreclosure; and (3) laws either abolishing deficiency judgments after foreclosure or limiting the right to such judgments by requiring the sale price of the mortgaged property to be based on the "fair," "reasonable," "just," or "equitable" value of the property. See 128 CCH 17501; Bridewell, "Digest of State Mortgage Moratorium Legislation and Judicial Interpretation of Same," Special Report No. 1, Subcommittee on Law and Legislation, Central Housing Committee, Washington, D. C.



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III. Cumbersome, Costly Mortgage Instruments

From a study of the accompanying maps, it is clear that the type of loan instrument used in each state and its wording must vary according to the substantive mortgage and foreclosure law of that state and the procedure there in effect. For instance, in order to provide for the type of foreclosure action used in a particular state, the form of instrument ordinarily used might be a mortgage with a power of sale or a mortgage without a power of sale. Or, again, it might be a deed of trust with a power of sale or a deed of trust without a power of sale.

In order to be absolutely certain that a loan instrument conforms to the mortgage and foreclosure law of the state in which the loan is made and that a good lien is acquired, it is almost essential that a lawyer draft the instrument so as to fit the facts of each particular case. The fees paid attorneys each year for such drafting of loan instruments run into millions of dollars. Since it is the mortgagor who in the end bears the cost of such fees, he is unduly penalized by the archaic state of the mortgage law which requires such meticulous care in the drafting of loan instruments.

Furthermore, in order to express the mortgage contract clearly and to protect fully both mortgagor and mortgagee, long and detailed instruments are required, which it is almost impossible for anyone except a lawyer to understand. The forms now used in the various states by the HOLC and the FHA, as well as by most government agencies and private lending institutions, contain from one to four thousand words.

Since these lengthy instruments must be recorded in order to be valid against subsequent purchasers, lienors, and judgment creditors, and since the fee for recording varies with the length of the instrument, the mortgagor, who must pay the recording fees, is still further penalized. The recording fee for mortgages or deeds of trust in most states now runs from four to ten dollars, depending upon the length of the mortgage. Although at least 22 states have statutory short forms of either a mortgage or deed of trust or both, these are rarely used because of lack of provision for the various covenants and conditions usually incorporated in such instruments.

Thus the mortgage law of the various states, which is so indefinite as to require the drafting of such lengthy instruments, causes a waste of millions of dollars a year in drafting and recording fees alone.

IV. Costly, Time-Consuming Foreclosure Procedures and Their Effect on Mortgage Lending

A. Costly, Time-Consuming Procedures. Chart I, Map IV, and Table I, based on statistics gathered in a recent survey of the foreclosure operations of the HOLC,[18] demonstrate the effect of existing laws on the cost of foreclosure and the time required therefor.[19]

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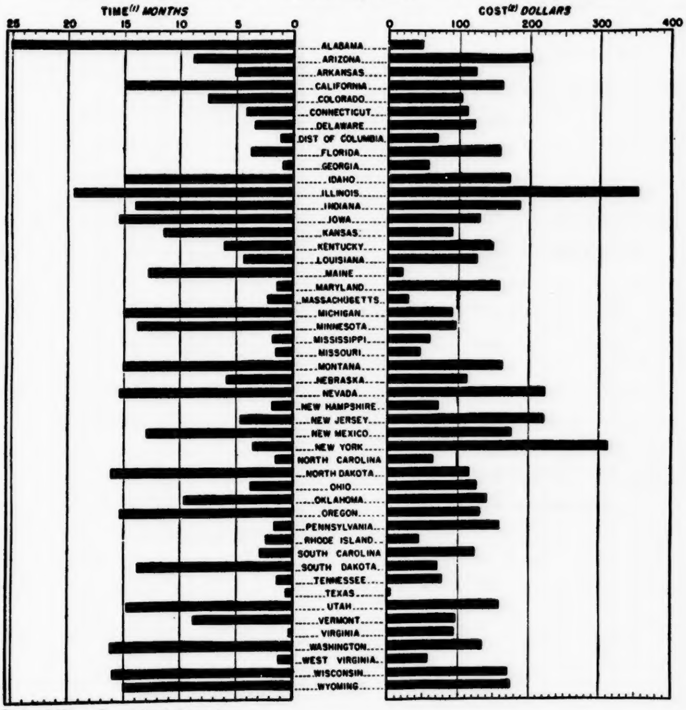
[18] Chart I and Table I are reprinted with permission from the November, 1937 *Federal Home Loan Bank Review.* The Survey of Foreclosure Operations of the HOLC was made by Henry Beaman, Senior Attorney, Foreclosure Section, Litigation Division, Legal Department, HOLC, with the assistance of Ralph W. Weese and C. J. Lester of the staff of the Division of Research and Statistics, FHLBB. A copy may be obtained upon request from the office of the General Counsel, HOLC. Map IV was prepared by Harold A. Lamberton, Division of Research and Statistics, FHLBB, and David A. Bridewell, HOLC, from statistics set forth in the survey.

[19] In studying the data set forth in the chart and tables it should be borne in mind that the time and cost elements for foreclosure arrived at in this study were less than if they represented privately instituted foreclosures, because the HOLC chose, whenever possible, the least expensive and shortest method of foreclosure; because costs did not include the cost to the Corporation of its salaried personnel, who supervised the fore-

(*Footnote 19 continued on page 307*)

Chart I. Average Time Required to Complete Foreclosure Compared with Average Cost of Foreclosure, Based on HOLC Experience.



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[1] In case of foreclosure in court, the time has been computed from the date of the filing of the petition to foreclose to the date of acquisition of title, free of redemption.

In case of foreclosure under power of sale contained in the mortgage or deed of trust, the time has been computed from the date of the first publication of notice of sale or of intention to foreclose, where such is required, to the date of acquisition of title, free of all rights of redemption.

[2] In Delaware, the District of Columbia, Massachusetts, Rhode Island and Texas, the foreclosure work is handled entirely by HOLC salaried attorneys. In Louisiana, Nevada, and Oklahoma, the foreclosure work is partially handled by HOLC salaried attorneys. The administrative cost to the HOLC of the work of these salaried attorneys is not included in the cost bars of these states. Therefore, this factor should be considered in comparing the costs in these states with those in others.

From the chart and tables it is to be noted that, with respect to the time required for foreclosure and the costs involved, the states may be roughly classified into three groups: (1) those in which cost of foreclosure is low (less than $100) and the time required in most instances short (less than three months);[20]

(*Footnote 19 continued from page 306*)

closure proceedings; and because the practicing attorneys who handled the foreclosures agreed to a smaller fee than they otherwise would have charged in return for the volume of business to be given them by the Corporation.

In support of this statement see Tables II and III below which supply a comparison of HOLC foreclosure costs with those of privately instituted foreclosures in four New York counties.

[20] Georgia, Massachusetts, Mississippi, New Hampshire, North Carolina, Rhode Island, Tennessee, Texas, Virginia, West Virginia, and the District of Columbia. Maine and Missouri should probably also be included in this group as the average cost of foreclosure in each of these states is less than $45. On the other hand, in both of these states there is a 12 months' redemption period during which the debtor is entitled to possession of the property. Alabama should probably also be included in this group, even though the period of redemption is 2 years, since the cost of foreclosure is less than $50 and since the purchaser and not the debtor is entitled to possession of the property during the period of redemption.

(2) those where cost of foreclosure is high (above $100) and the time to foreclose in many instances is unnecessarily long (more than three months);[21] and (3) where cost of foreclosure is not only high and the time to foreclose in many instances unnecessarily long, but where there is also a period of redemption of six months or more during which in most cases the mortgagor is entitled to possession of the property.[22]

Study of the costs incurred by the HOLC in foreclosing mortgages in the various states reveals that the average cost in states in the first group was approximately $55; whereas in states in the second and third groups it was approximately $155. This $100 differential per foreclosure might well be considered a useless expense or waste, since it is to be assumed that in all states an equally indefeasible title is gained by foreclosure proceedings.

If approximately 1,000,000 mortgages have been foreclosed during the past 10 years,[23] then at an average cost of $124 each, as found by the HOLC, $124,000,000 would have been expended for mortgage foreclosures. Assuming that $55, the approximate average cost of foreclosure in states in the first group, is sufficient to cover the cost of foreclosure, it appears that during the past 10 years approximately $70,000,000 has been spent unnecessarily because foreclosure procedures in all states were not as simple, inexpensive, and expeditious as in states in the first group.[24]

Furthermore, it has been estimated that the cost of the delay to a lender in obtaining an indefeasible title because of the time required to foreclose or to permit the running of the redemption period averages at least $2 per day on a $5,000 mortgage.[25] This estimated cost, of course, includes the loss of interest on the investment, accruing taxes, insurance, and depreciation. From this esti-

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[21] Connecticut, Delaware, Florida, Louisiana, Maryland, New Jersey, New Mexico, New York, Ohio, Pennsylvania, South Carolina.

[22] Arizona, California, Colorado, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Montana, Nebraska, Nevada, North Dakota, Oklahoma, Oregon, South Dakota, Utah, Vermont, Washington, Wisconsin, Wyoming. Arkansas should probably also be included in this group because of the cost of foreclosure and the 12 months' redemption period during which the debtor is entitled to possession of the property unless the period of redemption is waived.

[23] Holden, Arthur C., "The Menace of Mortgage Debts," 166 *Harper's* 575 (1933), estimates that the number of foreclosures in the United States in 1931, 1932, and 1933 was probably well over 500,000.

According to a "Report of Investigation on Cost and Procedure in Mortgage Foreclosure," which is a part of a "Survey of All Real Estate Laws," conducted in 1936 by the Works Progress Administration of the City of New York, 32,992 notices of foreclosure were filed in the Borough of Queens, City of New York, from 1930 to 1935. According to figures released by the Tax Department of the State of New York, there are approximately 175,000 one- and two-family homes in this borough. In other words, during the period 1930–5, more than one out of every ten homes in this Borough was in the process of foreclosure. See Fairchild, "Foreclosure Methods and Costs: A Revaluation," 7 *Brooklyn Law Review* 1 (1937).

In "HOLC Summary" (July 22, 1936) it was estimated that in a normal year, like 1926, approximately 68,000 homes were foreclosed; that in 1932 this figure had increased to 248,700 per annum; and that by June, 1933 foreclosures were occurring at an estimated rate of 24,000 a month. These figures are estimates made by the FHLBB based upon reports of local officers in over 1,000 communities in which live over half of the population of the United States. In the House Hearings on the National Housing Act (H. R. 9620), 73d Cong., 2d Sess., p. 63, figures averaging about 8% higher than these may be found.

From these various estimates, it is safe to conclude that at least 1,000,000 foreclosures have taken place during the last 10 years. Also see Note, 42 *Yale Law Journal* 1236 (1933).

[24] In this connection, see Russell, "Foreclosure Costs in New York," 13 *Journal of Land & Public Utility Economics* 221 (1937) in which it is stated that four million of the estimated five million dollars which the HOLC will spend in foreclosing mortgages in New York State will be a kind of "legalized waste." In an address on "Foreclosures in New York," delivered at the 50th Annual Convention of the New York State League of Savings and Loan Associations on June 16, 1937, Mr. Russell stated: "I estimate that mortgagees in New York wasted at least $40,000,000 in useless foreclosure costs in the past four years."

[25] The estimate of $2 a day was made by Mr. Russell in an address before the United States Building and Loan League at its annual convention in Los Angeles on October 7, 1937.

mate it is apparent that in states in the third group, which have a redemption period of a year or more, and in some states in the second which require over a year for foreclosure, including the period of redemption, an enormous waste occurs by reason of the delay necessitated by the local statutes.

B. Effect of Existing Foreclosure Procedures on Mortgage Lending. The effects of these time and cost factors in foreclosures upon mortgage lending need only be sketched. In states in the first groups where cost of foreclosure averages approximately $55 and the time required to complete foreclosure is less than two months, a lending institution can afford to lend up to a very high percentage of the value of the property at a low rate of interest because it does not have to deduct such a large amount from the value of the property or increase its interest rate to balance off the risk of possible foreclosure costs.

On the other hand, in states in the second and third groups, where the average cost of foreclosure is almost three times as much, or the time required to complete foreclosure, including the period of redemption, is greater than one year, or where both such conditions prevail, a lending institution cannot afford to lend with safety as high a percentage of the value of the property; or, if it did, it would have to charge a high interest rate to compensate for the risk involved. Thus, a borrower would be prevented from obtaining a loan in many instances or be forced to resort to the dangerous practice of junior financing.

Or, to express the situation somewhat differently, a lending institution in any state in the first group, which has lent $4,000 on a $5,000 home, is able to "carry" a defaulting borrower for many months, during which time he may rehabilitate himself, before the accumulated interest, taxes, insurance, and other carrying charges have brought the total debt up to a point where it has to foreclose in order to protect itself against loss on the loan.

On the other hand, a lender in any state in the second and third groups, which has lent $4,000 on a $5,000 home, would find it necessary to foreclose immediately in order to protect itself when the accumulated interest, taxes, insurance, and other carrying charges had raised the borrower's debt to $4,500 because of the high cost of foreclosure in those states or the cost of the delay from the long redemption period. Therefore, in these latter states a lending institution is prevented from granting voluntary short moratoria to the borrower in periods of financial misfortune.

Clearly, therefore, simple, inexpensive, and expeditious mortgage and foreclosure laws make possible more liberal practices on the part of lending institutions, thereby benefiting not only the mortgagee but also the mortgagor and facilitating mortgage lending in general.

C. Existing Foreclosure Procedures and the Federal Private Credit Program. During the past six years the Federal Government through its housing-finance agencies has been sponsoring long-term, amortized, single-mortgage lending at low interest rates on home properties,[26] hoping thereby to discourage short-term,

[26] The HOLC, during its lending operations, refinanced 1,021,587 home-mortgage loans, or approximately one out of every 10 home-mortgage loans in the country, on a 12- to 15-year repayment basis, amortized by installment payments of approximately $9 a month per $1,000 of loan, with one mortgage securing all debts refinanced and at an interest rate of 5%. This refinancing operation not only relieved home-owners in distress and helped liquefy the frozen mortgage assets of lending institutions, but placed at least one out of every 10 home-mortgage loans on a sound, long-term repayment basis. Further impetus has been given to long-term, amortized, single-mortgage lending by making it a condition for membership in the Federal Home Loan Bank System, by requiring it to be the major activity

(*Footnote 26 continued on page 310*)

lump-sum, multiple-mortgage lending[27] which is regarded by many as one of the basic weaknesses in the home-financing structure.

From what has been said above, however, it is apparent that existing mortgage and foreclosure laws are at least one in a series of factors which prevent complete realization of the federal program in many states. Since only through the medium of a long-term, amortized mortgage loan can many families of moderate means finance the purchase of a home, such families are prevented from receiving the full benefits of the federal program in states which have costly, time-consuming mortgage and foreclosure procedures.

Clearly, if many potential and prospective home-owners of moderate means are to receive full advantage of the generous benefits provided in the National Housing Act Amendments of 1938, the mortgage and foreclosure laws of many states must be substantially revised. By thus increasing the maximum amount which may be lent upon the security of a home property, the minimum down-payment required of a prospective home-owner is reduced from 20 to 10% of the sale price or cost of the property; e.g., the minimum down-payment which would be required on a $3,000 home financed through an FHA-insured mortgage would be $300.00. But, according to the cost of foreclosure brought out in the study of the HOLC experience, it is apparent that in many states this cost together with the delay to the lender would more than cancel out this initial down-payment in the event of default soon after the loan was made.

Consequently, in those states where the cost of foreclosure is in excess of $200.00 or where the mortgagor is entitled to a period of redemption of one year or longer, or in states where both such conditions are in effect, a mortgage loan up to 90% of the appraised value of a home property costing $6,000 or less would involve considerable risk both to the institution which made the loan and to the FHA which insured it.

From the standpoint of a lending institution, this is true regardless of the fact that the FHA is authorized to insure such loans up to that percentage of appraised value and, in the event of default, to issue its debentures in an amount to cover (1) the principal obligation of the mortgage which is unpaid at the institution of foreclosure proceedings, (2) all payments made by the mortgagee for taxes, special assessments, and insurance, and (3) the cost of foreclosure, in the case of mortgages upon which less than 10% of the principal has been repaid. Even with such liberal insurance coverage, an element of risk to lending institutions still remains because the foreclosure cost for which debentures may be issued is limited to an amount not in excess of 2% of the unpaid princi-

(*Footnote 26 continued from page 309*)
of federal savings and loan associations, and by making it a condition for mortgage insurance with the FHA.

[27] Short-term mortgage loans on home properties are generally bad practice as they must be refinanced every few years, with the high commissions and financing charges which that operation entails. Lump-sum mortgage loans are generally bad practice as they necessitate repayment of the entire loan at one time or refinancing it with the high fees which that operation entails. Multiple-mortgage financing of a single property is generally bad practice not only because of the high fees incident to procurement of each mortgage, but of the increased dangers of default.

It may be estimated that, prior to the depression, approximately 50% of the home-mortgage financing of the country was on a short-term, lump-sum basis, with many properties securing more than one mortgage. With the greater part of this percentage of the home-mortgage debt of the country falling due during the depression years, with lenders clamoring for repayment and refusing to grant extensions or renewals because of their need of liquidating their investments in order to obtain cash, and with borrowers unable to repay the large lump-sum payments required by their mortgage contracts because of reduced incomes, the evils in this system of mortgage financing were laid open to scrutiny during the depression period.

pal of the mortgage as of the date of the institution of foreclosure proceedings or $75, whichever is less.[28]

Of course, the Federal Housing Administrator is authorized to issue to a mortgagee who has foreclosed upon an insured mortgage, in addition to debentures, certificates of claim in an amount sufficient, when added to the face value of the debentures, to equal the amount which the mortgagee would have received if the mortgagor had redeemed and paid in full all obligations under the mortgage and the expenses incurred by the mortgagee in connection with foreclosure.[29] However, these certificates of claim are paid off only if, after sale of the property and payment of incidental expenses in connection therewith, a surplus remains over and above the debentures previously issued to such mortgagee.[30]

Consequently, in states where the cost of foreclosure is in excess of $200.00 or where the mortgagor is entitled to a period of redemption of one year or longer, or in states where both such conditions are in effect, it would appear that, where less than 10% of the obligation has been repaid, a sufficient surplus will not remain to pay off such certificates of claim. It is to be expected, therefore, that home-financing institutions, in states where such conditions prevail, will protect themselves by continuing to lend less than 90% of the appraised value of the property.[31] Consequently, prospective home-owners and home-financing institutions in states which have a simple, inexpensive, and expeditious foreclosure procedure should be in a better position to take full advantage of the benefits provided by the National Housing Act Amendments of 1938 than those in states where foreclosure conditions are the reverse.

But the difficulties encountered in protecting a mortgage loan are not limited to ordinary lending agencies. The liberalization of Title III of the National Housing Act of 1934 so as to make organization of national mortgage associations more attractive and their securities more salable makes more imperative than ever before the revision of mortgage and foreclosure laws along uniform lines. Obviously, the more uniform, simple, inexpensive, and expeditious are the mortgage and foreclosure laws of the various states, the easier it will be for such associations to function smoothly and transact their business of making, buying, and selling mortgage loans on a nation-wide basis.

D. Useless Expenses Involved in Foreclosure. A study of any statistics on the separate factors in the total cost of foreclosure demonstrates that in most states many useless expenses are incurred by reason of the many unnecessary procedures required by the state laws. Table I, which shows various items of foreclosure costs as percentages of the total foreclosure cost by states,[32] illustrates

[28] Sec. 204(a) of the National Housing Act, as amended, 12 U.S.C. 1710(a).

[29] *Ibid.*, Sec. 204(e); 12 U.S.C. 1710(e).

[30] *Ibid.*, Sec. 204(f); 12 U.S.C. 1710(f).

[31] For discussions of depreciation costs and other factors which might prevent home-financing institutions from lending up to 90% of the value of a home property on a 20- to 25-year repayment basis, see Beach, "Are 20-Year Mortgage Loans Safe?" 14 *Journal of Land & Public Utility Economics* 19 (1938); and Guthmann, "Making Home Ownership Safe," 14 *Ibid.* 26 (1938).

[32] In studying this table it should be kept in mind that the percentages shown are based upon the ratio which the total of each of the principal elements of cost in each state bore to the total cost of foreclosing on all mortgages in each particular state, rather than upon the ratio which the average of these principal elements bore to the average cost. It was impossible to show percentages of the average cost because all foreclosures within a state did not always include the same items. Thus, in New York, only 23% of the total sample included costs for auctioneers' fees or trustees' fees, because in the upstate districts no such fees are charged. Although these percentages were computed as set forth above, they give a rough picture of the *relative* extent to which each item of cost went to make up the average cost.

It should also be kept in mind that, since the various

(*Footnote 32 continued on page 312*)

TABLE I. HOLC FORECLOSURE COSTS AND THE TYPE OF FORECLOSURE ACTION, BY STATES*

State	Type of action[a]	Percent of total loan amount	Principal Items as a Percentage of Total Costs to HOLC										Average cost of foreclosure
			Attorney's fees	Advertising cost	Commissioner's, trustee's, and/or sheriff's fees	Court costs	Title search	Auctioneer's fees	Recording fees	Revenue stamps	Master in chancery's fees	Other	
Alabama	P	1.2	69.9	25.0					2.7	2.4			$ 47.95
Arizona	C	5.4	58.6		18.1	13.4	5.3		1.5	2.3		0.8	202.38
Arkansas	C	5.6	40.6	0.8		37.0	18.6		1.1	1.9			123.18
California	C	4.0	49.9		26.1	8.5	9.4		1.7	3.0		1.4	161.34
Colorado	P	3.6	50.2	9.4	5.0		31.0		1.5	2.9			102.65
Connecticut	C	1.9	63.6			[b]36.4							111.00
Delaware	C	2.9	[c]	52.3		39.6			2.5	1.0		4.6	120.93[c]
District of Columbia	P	1.0	[c]	64.7				22.0	3.1	9.1		1.1	68.75[c]
Florida	C	5.2	60.8	7.9	3.6	6.8	9.8		1.1	0.5	9.5		158.16
Georgia	P	1.9	52.5	42.5					2.7	2.3			56.70
Idaho	C	6.0	50.1		29.7	13.1	3.8		0.9	2.1		0.3	170.98
Illinois	C	6.3	34.7	4.8		7.9	13.5		0.3	1.8	34.8	2.2	354.30
Indiana	C	4.6	48.1			[b]31.1	5.8		0.7	2.7		11.6	185.61
Iowa	C	4.0	59.7	0.5		[b]30.0	5.5		1.0	3.0		0.3	129.35
Kansas	C	3.7	55.1			34.8	5.4		3.3	1.4			90.88
Kentucky	C	4.2	50.3		36.4	10.0			1.1	1.9		0.3	149.23
Louisiana	C	2.7	[d]	31.1	28.0	18.8			11.8	0.9		9.4	125.23[d]
Maine	S	0.6	46.9	47.8					4.9			0.4	21.32
Maryland	P	4.4	31.7	21.9	6.3	22.0			2.5	2.2	5.9	7.5	157.56
Massachusetts	P	0.5		56.9				27.8	15.3				29.08[c]
Michigan	P	1.9	50.3	34.6	3.3	0.1			4.6	6.5		0.6	90.52
Minnesota	P	2.6	61.2	21.4	16.6				0.7			0.1	96.11
Mississippi	P	1.8	59.5	33.4					2.8	4.3			58.81
Missouri	P	0.7	[d]	78.5					11.3	10.2			48.40[d]
Montana	C	5.8	75.6		7.6	8.9	4.6		0.9	2.3		0.1	161.74
Nebraska	C	5.4	45.0			47.1	7.1		0.2			0.6	112.19
Nevada	C	3.8	59.8		18.3	13.2	4.4		1.3	2.8		0.2	223.01[d]
New Hampshire	P	2.0	60.6	21.2				7.8	5.8	4.6			70.82
New Jersey	C	4.7	38.0			[b]62.0							222.29
New Mexico	C	6.9	54.0	11.4		6.8	12.1		0.9	1.5	7.8	5.5	175.38
New York	C	5.9	40.0	17.5		2.3	5.4	2.0	0.7	1.3	29.1	1.7	312.54
North Carolina	P	1.4	55.5	22.5	2.4	[b]12.8				6.8			64.07
North Dakota	C	4.1	51.8	13.5	13.3	5.7	5.5		4.2	3.0		3.0	114.94
Ohio	C	2.9	39.5		0.2	[b]49.6	3.6		1.1	3.1		2.9	125.46
Oklahoma	C	4.2	30.7	12.9	10.7	11.3	26.0		1.5	2.1		4.8	130.97[d]
Oregon	C	4.6	56.5		9.7	16.2	12.0		1.5	2.6		1.5	130.37
Pennsylvania	C	3.6	31.8	41.5	4.2	[b]21.7			0.4	0.4			158.27
Rhode Island	P	0.8	[c]	56.4				23.0	10.7	9.9			44.72[c]
South Carolina	C	4.7	50.0	14.0	23.5	10.0		1.2	1.1			0.2	123.25
South Dakota	P	3.1	45.5		43.4		0.7		10.4				70.84
Tennessee	P	2.4	64.5	28.4					3.3	3.6		0.2	77.51
Texas	P	0.2	[c]						65.2	34.8			5.18[c]
Utah	C	4.9	66.2		12.8	12.7	3.9		1.4	2.6		0.4	158.33
Vermont	C	2.2	64.4			35.6							97.14
Virginia	P	1.7	42.3	33.0	14.1	0.1			5.4	4.8		0.2	94.8
Washington	C	5.4	55.1		17.1	16.9	7.1		1.1	2.4		0.3	134.40
West Virginia	P	1.2		39.8	46.7	2.6			4.8	6.1			56.93
Wisconsin	C	3.1	52.7			[b]33.3	10.2			2.9		0.9	169.94
Wyoming	C	7.2	61.7		23.9	3.1	7.9		1.2	1.8		0.4	174.11

* Based on as near 100 foreclosures as possible for each state.

[a] Consists of power of sale (P), court action (C), or (S) strict foreclosure by publication with no sale. When any one of these is allowed, that list has been used principally by the HOLC.

[b] Extra items included in court costs: Connecticut—all items; Indiana—sheriff's fees, advertising cost; Iowa—sheriff's fees and some advertising costs; New Jersey—all items; North Carolina—recording fees; Ohio—advertising fees; Pennsylvania—most recording fees; and Wisconsin—publication for sale, sheriff's fees, recording fees.

[c] Average foreclosure costs do not include attorneys' fees in Texas, Massachusetts, Delaware, District of Columbia and Rhode Island, as foreclosure is handled by HOLC salaried personnel and the cost of these services is not included in total costs.

[d] Average foreclosure costs do not include a full charge for attorneys' fees in Louisiana, Missouri, Nevada and Oklahoma as foreclosure is partially handled by HOLC salaried personnel.

(*Footnote 32 continued from page 311*)
elements of cost which go to make up the total cost of foreclosure are expressed in terms of percentages, the percentage of total costs given in some cases may be disproportionately high because the total aggregate cost for foreclosure is quite nominal. For instance, since foreclosure is handled by the HOLC's salaried attorneys in Texas without extra cost, as a part of their business routine, and since the total cost of foreclosure in that State is therefore but $5.18, the cost of revenue stamps and the recording of the deed make up together 99% of total foreclosure costs.

TABLE II. ELEMENTS OF COST IN TOTAL COST OF FORECLOSURE IN THE FOUR COUNTIES COMPRISING THE METROPOLITAN AREA OF NEW YORK CITY, BASED ON HOLC EXPERIENCE

Foreclosure Fees and Costs	Queens County[a]	New York County[b]	Kings County[a]	Bronx County[a]
Referee to compute	$ 24.00	$ 25.00	$ 25.00	$ 25.00
Referee to sell	75.00	74.31	75.00	75.00
Advertising bill	45.47	105.73	74.52	124.30
Auctioneer's fee	1.80	30.00	28.20	28.80
Attorney's fees	120.00[c]	109.38[c]	125.00	125.00
Miscellaneous	50.50	52.39	49.91	51.30
Total	$ 317.66	$ 396.86	$ 376.84	$ 430.12
Average loan amount	$6,735.40	$9,907.21	$6,738.95	$8,070.74
Time to complete	5.8 months	5.4 months	5.2 months	4.9 months

[a] The fees and costs set forth in this column are averages based on the actual fees and costs paid by HOLC in 25 representative foreclosure cases in this County.
[b] The fees and costs set forth in this column are averages based on the actual fees and costs paid by HOLC in eight representative foreclosure cases in this County.
[c] Average attorney's fee in this County was less than that in Kings and Bronx Counties because HOLC salaried attorneys were used in one of the cases analyzed, for which services no fee is shown.

this statement. Confirmation is also found in Tables II and III below which set forth a breakdown of the averages of the various cost elements which went to make up the total cost of foreclosure in the four New York counties embraced in the metropolitan area of New York City.[33]

Table I shows that the cost of publishing in a newspaper a notice of the pendency of a foreclosure action accounts for an average of approximately 29% of the average total cost of foreclosure in states requiring this method of notice, ranging from .5% of average total costs in Iowa to 78.5% in Missouri. Table II shows that the average cost to the HOLC of this method of giving notice in the metropolitan counties comprising New York City ranges from $124.30 in Bronx County to $45.47 in Queens County, with an average of $87.50 for the four counties. It is a matter of general agreement among practicing attorneys that publication of such notice does not bring buyers to the sale and, therefore, benefits no one except, of course, the newspaper obtaining the advertisement. Rarely does it happen that any other person than the plaintiff mortgagee or his nominee is the purchaser at the sale. Therefore, publication of notice other than that actually neces-

[33] For an excellent analysis of the excessive costs and the uncertainties involved in the present New York foreclosure procedure, see Fairchild, *op. cit.*

TABLE III. ELEMENTS OF COST IN TOTAL COST OF FORECLOSURE IN THE FOUR COUNTIES COMPRISING THE METROPOLITAN AREA OF NEW YORK CITY, BASED ON A STUDY OF PRIVATELY INSTITUTED FORECLOSURES[a]

Items of Fees and Costs	Queens County[b]	New York County[c]	Kings County[d]
Referee's fees	$ 89.70	$ 97.31	$ 83.15
Advertising bill	70.46	191.22	99.87
Auctioner's fee	21.67	47.11	33.51
Statutory costs	36.06	43.96	40.09
Total disbursements	81.96	92.81	86.54
Interest on costs	1.35	2.27	.45
Guardian fees	1.21	.74	.43
Allowance[e]	148.16	176.41	163.02
Extra allowance[f]	125.46	190.25	156.32
Total	$576.03	$842.03	$663.38

[a] The average elements of cost set forth in this table are taken from a more comprehensive chart appearing in Fairchild, *op. cit.*, which summarizes the figures set forth in the "Report of Investigation on the Cost and Procedure in Mortgage Foreclosure." This report was a part of a "Survey of All Real Estate Laws" conducted in 1936 by the WPA of the City of New York.
[b] The fees and costs set forth in this column are averages based on the actual fees and costs paid in 1,800 privately instituted foreclosure actions during 1930 to 1935, inclusive, in this County.
[c] The fees and costs set forth in this column are averages based on the actual fees and costs paid in 433 privately instituted foreclosure actions during 1930 to 1935, inclusive, in this County.
[d] The fees and costs set forth in this column are averages based on the actual fees and costs paid in 255 typical privately instituted foreclosure actions during 1933 to 1935, inclusive, in this County.
[e] Allowances under Sec. 1512, C.P.A. are determined by the amount of the judgment of foreclosure.
[f] Extra allowances are granted pursuant to Sec. 1513, C.P.A. Although the allowance is discretionary, it is granted by the court almost as a matter of routine.

sary to meet the requirements of due process of law, where no other notice is given, is an unnecessary expense.

Table I also shows that fees of auctioneers and masters in chancery account for an average of approximately 14% and 17%, respectively, of the average total cost of foreclosure in states which require sale by such officials. Auctioneers' fees range from 1.2% of average total costs in South Carolina to 27.8% in Massachusetts; and masters' fees from 5.9% of average total costs in Maryland to 34.8% in Illinois. Table II shows that the modal cost to the HOLC of having a public auctioneer sell the property at the foreclosure sale in three of the four metropolitan counties comprising the City of New York was approximately $28.00. The requirement that a public auctioneer or a master in chancery auction the property is of little value since usually no one bids at the sale except the mortgagee or his nominee, as pointed out above. Furthermore, the fees allowed for these services in New York and in most states are probably out of all proportion to the services rendered, for generally they consist only of reading the terms of sale and recording bids.

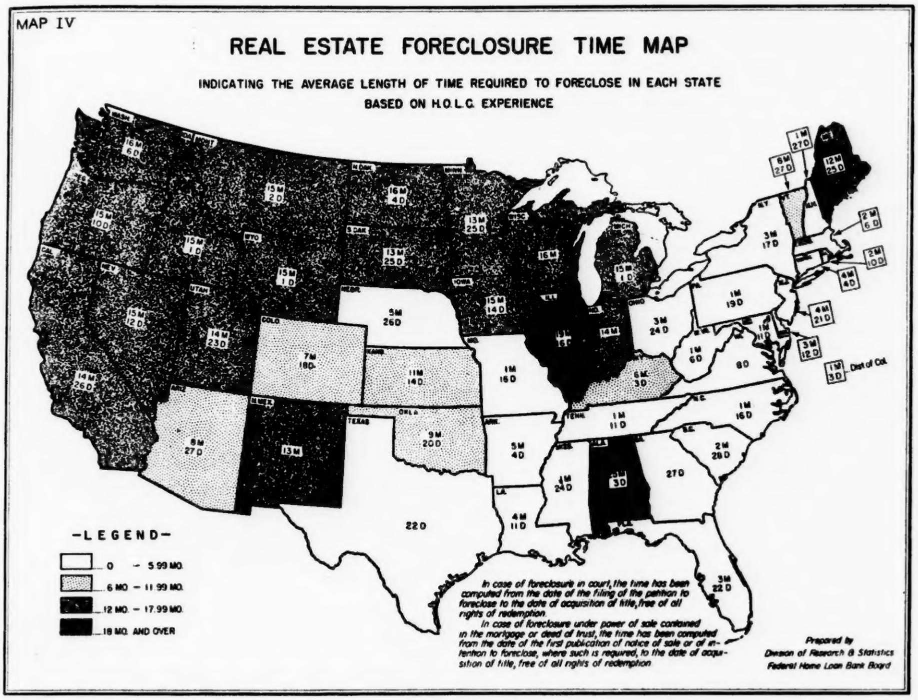
Likewise, appointment of referees to compute the amount due and supervise the sale, as required in a few states, merely adds fees for which there is little or no justification. A referee rarely does more than sign his name to the computations of the debt made by the mortgagee, engage an auctioneer to sell, attend the sale, and sign the report of sale and deed to the purchaser, which are usually prepared by the mortgagee's attorney. According to Table II, the average cost to the HOLC of having a referee compute the amount of the debt and supervise the sale in the metropolitan counties comprising the City of New York was approximately $25.00 and $75.00, respectively.

Furthermore, Table I shows that attorneys' fees account for an average of approximately 52% of the total foreclosure costs in those states where fee attorneys were employed, ranging from an average of 30.7% of average total costs in Oklahoma to 75.8% in Montana. The corresponding figure in the New York counties was approximately $125.00 (Table II). There is a close correlation between the size of the attorneys' fees and the work and detail involved. For instance, by contrasting Table I with the maps (especially Map IV), attorneys' fees are seen to run high in states where foreclosure statutes are cumbersome and require a great amount of detailed work over a long period of time. On the other hand, such fees are low where the statutes provide for a simple, expeditious procedure.

In addition, it is questionable whether the long redemption period provided for in the states previously classified in the third group can be justified. Such periods prove of little benefit to the mortgagor because, to exercise this right, he must pay the entire debt in cash during the redemption period, which of course is usually impossible as there never would have been a foreclosure if he had been able to pay the debt or a substantial part of it in cash.[34]

On the other hand, such redemption periods actually result in an approximate cost of $2.00 a day to the mortgagee, against the possibility of which he in turn protects himself by lending a smaller amount on the security of the property mortgaged or charging a higher rate of interest, as pointed out above.

[34] A recent study of HOLC experience shows that out of 22,000 properties foreclosed, only 204 were redeemed despite the substantial periods of redemption permitted in most cases.



Furthermore, such statutes also materially impair the mortgagee's security since outside purchasers will not bid freely for property, the title to which is subject to redemption for a long period of time. As a consequence, this tendency enables and encourages the mortgagee to bid in the property at a nominal amount, thus laying the basis for a large deficiency judgment.

The aforementioned unnecessary procedures and many others were originally devised in most states to protect the helpless borrower against the supposed greed of the money-lender. They have served as a boomerang in most cases, however, by preventing a prospective borrower from obtaining a loan on as advantageous terms as he otherwise might if such procedures were not required by the law of his state.

V. The Uniform Act

With the existing costly, time-consuming mortgage and foreclosure procedures in mind, the Subcommittee on Law and Legislation of the Central Housing Committee undertook to draft a uniform act which would be subject to none of the above criticisms, which would facilitate rather than impede long-term, amortized, single-mortgage lending, and which would be adequate to weather the storms of subsequent depressions without extensive amendment.

A. Definitions. Article I relates solely to the title of the act and the definitions of the terms used therein. Particularly interesting is the definition of the term "mortgage," which is defined as an "instrument whereby a lien is created upon real estate . . . or whereby title to real estate is conveyed to another

person" as security for the payment of an obligation or the satisfaction of a legal duty. In adopting this definition, the troublesome question of whether a mortgage is a lien upon, or the conveyance of legal title to, the real estate is avoided.[35]

B. Application of Act. Article II limits application of the act to mortgages executed after the act shall have been passed. However, it does permit a mortgagor and mortgagee to agree, in a recorded writing, that the provisions of the act shall apply to any mortgage executed before the law was passed.[36] This article then provides that the form of mortgage set forth in Article III shall be lawful and may be used by anyone, but that no one is required to use it. Use of other lawful forms of mortgage instruments is therefore not prohibited. In the event of use of the statutory form of mortgage, any of the covenants contained therein may be omitted or additional covenants may be added, but those added must be designated "non statutory." This article further provides that any power of sale or right of sale contained in any mortgage made after the act becomes effective must be foreclosed in accordance with provisions of the statute.

C. Statutory Short Mortgage Form. Article III sets forth a statutory short form of mortgage, about 160 words in length, which is provided in order to reduce the expenses incident to recordation and the preservation of official records, and to simplify and promote uniformity of mortgage instruments throughout the entire country.[37] In this statutory short form of mortgage, which contains 10 covenants, the mortgagor, in addition to warranting title, promises to pay both the obligation secured and the taxes, to keep the building insured, to avoid waste and to keep the premises in repair, to defend the mortgage, to pay off prior mortgages or other liens and to assign, under certain circumstances, the rents and profits of the mortgaged premises to the mortgagee. It is also provided that the mortgagee may advance up to the maximum amount fixed in the mortgage on the security of the mortgage. Upon the breach of any covenant in the mortgage, the mortgagee has the statutory right of sale.

This same article then defines in detail the meanings of the provisions in the statutory mortgage form. These meanings are so drafted as to secure to the mortgagee adequate protection for his investment, while, at the same time, protecting the mortgagor. It is expressly provided that the meanings of those covenants, as set forth in the act, shall have legal effect in accordance with their terms, and be interpreted in accordance with such terms by every court in a state which has adopted the act.[38]

While the form is that of a mortgage, it can be easily converted into a deed of trust form and used under the act. The definition of the word "mortgage" used in the act includes deeds of trust.

D. Foreclosure by Power of Sale. Article IV sets forth the procedure for foreclosures which are exercised by power of sale, saving to mortgagees, however, their right to foreclose by court action if they so desire.[39] By making

[35] See comment, Legis., 86 *University of Pennsylvania Law Review* 517, 518–9 (1938).

[36] Constitutional questions based on impairment of contract obligations under Article I, Section 10 of the U.S. Constitution are thereby avoided.

[37] See Roberts, "Unifom Mortgage Act," 15 *Kentucky Law Journal* 22, 28 (1927); MacChesney, *op. cit.*, §333.

[38] The power of a state legislature to define its own language and thereby bind the courts is well established and, for the sake of uniformity and certainty, desirable. See Legis., 86 *University of Pennsylvania Law Review* 189, 195 (1937).

[39] See comment, Legis., 86 *University of Pennsylvania Law Review* 517, 520 (1938).

foreclosure by power of sale the principal method of foreclosure and by strictly regulating it, the Subcommittee hoped to provide an economical, expeditious method, which would give purchasers a perfect title to the property sold and, at the same time, afford mortgagors adequate protection.[40]

Upon a breach of any covenant, any recorded mortgage may be foreclosed under provisions of the act by either the mortgagee or his agent if such mortgage has a right of sale embodied in it. Exercise of the right of sale is instituted by giving notice of the mortgagee's intention to foreclose. A statutory form of such notice is provided and this form must be recorded in the office where the mortgage is recorded at least 90 days prior to the date set for the foreclosure sale. Three publications in a local newspaper are also required, spaced a week apart, during the three weeks' period immediately preceding the date of the sale. In addition, a copy of the notice must be mailed to each person interested in the premises covered by the mortgage who is actually known to the mortgagee, but failure to mail this notice will not invalidate foreclosure nor support an injunction against the sale.[41]

This last provision was inserted to make indefeasible a title procured through foreclosure. Such assurance of good title should have a tendency to attract bidders and stimulate higher bidding at foreclosure sales and, indirectly, result in loans being made on a higher percentage of property value.

The procedure for selling the property at foreclosure sale is also specifically prescribed in this article. The sheriff, who is defined in Article I as "any officer authorized by the laws of this state to execute the processes of a court within the jurisdiction of which a foreclosure sale is held," is required to sell the property at the highest bid price. Should a property consist of more than one parcel, it must be offered, first, in parcels, then in its entirety, and sold finally according to the method whereby the highest price can be obtained.[42] Any person interested in the mortgaged premises may bid.

The sale is not complete until the sheriff has collected the purchase price. The proceeds are then applied, first, to the payment of statutory costs and attorney's fees, secondly, to the mortgage debt, and, finally, the balance, if any, is paid over to the mortgagor.

E. Court Review of Foreclosure. In order to prevent an unconscionable exercise of the power of sale and to assure compliance with the statutory provisions as to foreclosure by power of sale, thus avoiding the objections that have been raised to an unrestrained exercise of the power of sale,[43] any person having an interest in the mortgaged property or in the obligation secured by the mortgage may, at any time after notice of and before the date of the sale, enjoin the sale upon a proper showing to the proper court that there is any substantive

[40] For an analysis of the advantages of foreclosure by power of sale, see Legis., 38 *Harvard Law Review* 651, 658 (1925). For a discussion of the objections to the unrestricted exercise of the power of sale, see MacChesney and Leesman, "Mortgages, Foreclosure and Reorganization," 61 *Illinois Law Review* 287, 289 (1936).

[41] This procedure for giving notice is somewhat more detailed than that in some states operating under "power of sale" foreclosure plans, but not more so than the procedure in most of the states which require court foreclosure. The various methods not only protect all interests involved, but are the most simple, inexpensive, and expeditious methods which could be devised for giving notice to all interested parties. These methods are more than adequate to meet the federal constitutional requirements of due process of law. In fact, notice by publication is sufficient. See *American Land Company v. Zeiss*, 219 U.S. 47, 31 S. Ct. 200, 55 L. Ed. 82 (1911). Also see *U.S. v. Fox*, 94 U.S. 315, 24 L. Ed. 192 (1876).

[42] See comment, Legis., 86 *University of Pennsylvania Law Review* 517, 521 (1938).

[43] See Legis., 38 *Harvard Law Review* 651, 658 (1925).

reason why the sale should not take place. Likewise, such persons may, within 30 days after the foreclosure sale, petition the court for a rescission of the sale. However, rescission of the sale may be had only for specific violations of the statutory provisions as to foreclosure at or after the sale.

By thus limiting to 30 days the period in which an action may be brought to rescind the sale, the proposed uniform act avoids the disadvantages to the mortgagor and the mortgagee of an insecure foreclosure title, and at the same time offers the mortgagor and other lienors sufficient time in which to take advantage of the privilege. If either the action to enjoin or the action to set aside the foreclosure sale is successful, the mortgagee does not lose his right of sale, since an unsuccessful attempt to exercise a right of sale does not exhaust that right.

Provision is also made whereby the mortgagee or the purchaser at the foreclosure sale may petition the proper court for confirmation of the foreclosure sale within 30 days after its date. Although the sale becomes final after 30 days if no action to rescind is brought by the mortgagor, this provision nevertheless affords mortgagees and purchasers a procedure for establishing the validity of the sale.

F. Redemption Period. Article III further provides a statutory redemption period of 30 days, during which time the mortgagor may tender to the sheriff the foreclosure sale price and become entitled to a certificate of redemption to the property. Although only a 30-day redemption period is provided, the six months' period, which probably will be required for foreclosure under the act, is sufficient to afford ample protection to the mortgagor and to enable him to redeem if he is able and willing to do so.

The interest in the property received by the mortgagor upon an exercise of his statutory right of redemption is not that of the purchaser, but his own original interest, subject to all liens and equities then existing or subsequently accruing.

G. Deficiency Judgments. If a foreclosure sale does not produce a sum sufficient to satisfy the unpaid balance of the debt secured by the mortgage plus statutory costs and attorneys' fees, the mortgagee is permitted to seek a deficiency judgment within 30 days after the foreclosure sale either in connection with a petition for confirmation of the sale, as a cross bill in an action to rescind the sale, or by a proceeding on the obligation secured by the mortgage. The purpose of these provisions is to speed up litigation. The right to a deficiency judgment is limited to a six months' period after the date of sale.

To support a deficiency the mortgagee must state that, at the time of the sale, the property was sold at its "fair market value" and that, at that time, it did not have value equal to the unpaid balance of the obligation secured by the mortgage plus statutory costs and attorney's fees.

In the event of default of appearance by the debtor, the court may enter judgment for the deficiency claimed. If the debtor appears in court and asserts that the mortgaged premises did have a "fair market value" equal to or in excess of the unpaid balance of the obligation plus statutory costs and attorney's fees, the court must determine the fair market value of the mortgaged premises at the time of sale. If that value is determined to be less than the amount of the unpaid balance of the obligation plus statutory costs and attorneys' fees, the court must allow as a deficiency the difference between such value and that amount. If the premises brought at the sale a larger

amount than determined by the court to be the fair market value, then the deficiency allowed to the mortgagee must be the difference between the amount so obtained at the foreclosure sale and the amount of the unpaid balance of the obligation plus statutory costs and attorneys' fees.[44] Provision is also made, if the parties agree, to have a committee appraise and their appraisal fixes the "fair market value" of the property.

Article III also provides a statutory form of certificate of sale which must be issued by the sheriff 30 days after foreclosure sale, unless court proceedings under the prior provisions of the act have been commenced, in which case such certificate may not be executed until it is finally determined that the foreclosure sale will stand. It is expressly provided that delivery of this certificate finally passes full title to the mortgaged premises, subject to any prior encumbrances or liens which were not extinguished by the foreclosure proceeding. Seven days after this certificate is recorded, the foreclosed mortgagor may be evicted from the premises as a trespasser.

H. Substantive Provisions. Article V provides that the mortgagee has no right of possession, nor a right to rents and profits except as provided in the mortgage. Through the interpretation of the short covenants contained in the mortgage form, however, certain contingencies are provided for, in which event the mortgagee is entitled to possession and to receive on behalf of the mortgagor the rents and profits. These contingencies are: (1) in the event the mortgagor should abandon the premises, the mortgagee is entitled to possession and to the rents and profits until the obligation secured by the mortgage is paid in full; and (2) in the event of a breach by the mortgagor of any one of the covenants contained in the mortgage, the mortgagee shall have a right to collect and receive on behalf of the mortgagor all rents and profits, which the former, in his discretion, may apply upon the mortgage debt or for repair of the property.

It is further provided that, when a mortgage expressly states a maximum amount which may be advanced in the future thereon, any advance made thereunder shall be protected by the mortgage with the same priority as the original debt. Any additional advances may be protected by the mortgage but are inferior to intervening liens. These provisions with regard to future advances were inserted to facilitate long-term, amortized, single-mortgage lending, and to enable the mortgagor to obtain future advances from the mortgagee for repairs, taxes, etc., without the necessity of executing a second mortgage, as is common practice today.[45]

[44] This provision is modeled after many recent state statutes limiting the right to a deficiency judgment. See 128 CCH 17501; Bridewell, "Digest of State Mortgage Moratorium Legislation and Judicial Interpretation of Same," Special Report No. 1, Subcommittee on Law and Legislation, Central Housing Committee, Washington, D. C. (1936). It was added as a result of experience during the recent depression. The collapse of the real estate market during that period with the resulting lack of demand for real estate properties forced mortgagees to bid in the property at foreclosure sales, usually without competition and at nominal amount, thereby laying the basis for large deficiency judgments on the note secured by the mortgage. As a consequence, mortgagors, in many cases, in addition to losing their property, would have large deficiency judgments entered against them, which they were unable to repay and which would ruin their credit rating in their community. Such judgments, in most instances, could be cleared only through bankruptcy proceedings. See Note, 47 *Harvard Law Review* 299 (1933). Some commentators have suggested complete abolition of deficiency judgments as a method to avoid the worst results of the present system. See MacChesney and Leesman, "The Mortgage Foreclosure Problem," 23 *A.B.A.* 41, 47 (1937); Legis., 86 *University of Pennsylvania Law Review* 517, 525 (1938). The Subcommittee, however, was of the opinion that the procedure provided would better protect the interests of both mortagors and mortagees.

[45] This article also provides that a mortgage equally

(*Footnote 45 continued on page 320*)

I. Limitations on Foreclosure Actions. Article VI provides a period of limitations within which time an action to foreclose a mortgage must be brought. Otherwise, the action will be barred and the interest conveyed by the mortgage will revert to the mortgagor. This period is fixed at 10 years from the date of the maturity of an obligation secured by a mortgage. However, by a prescribed procedure, the mortgagee may extend this period for an additional 10 years, and extensions for similar periods may also be made by agreement between the mortgagor and the mortgagee, in which case the additional period runs from the date the extension agreement is recorded.

In cases where the maturity of an obligation is not ascertainable, the period within which an action must be brought is 50 years from the date of the mortgage. The effect of these provisions would be to void and outlaw old mortgages not satisfied of record and clear titles to real property.

The statute of limitations is tolled by publication of notice of foreclosure sale, and the action to foreclose may be completed even though the statute of limitations has run.[46]

J. Miscellaneous Provisions. Article VII provides that the act shall be liberally construed and that the common law shall cover cases not provided for in the act, and contains separability and repeal provisions.[47]

VI. Remedial Results Which Would Be Achieved by General Adoption of the Uniform Act

The Subcommittee on Law and Legislation of the Central Housing Committee believes that general adoption of this Uniform Real Estate Mortgage Act would result in a vastly simplified and improved mortgage-lending situation from the point of view of both borrowers and lenders; that it would increase the maximum amounts which lenders may safely lend, lower interest rates, and facilitate long-term, amortized, single-mortgage lending and the carrying out of the federal housing-credit program embodied in the National Housing Act Amendments of 1938; that it would make easier the purchase and sale of mortgage investments by mortgage-lending institutions and thereby make such investments more liquid; that it

(*Footnote 45 continued from page 319*)
secures, without priority, every instrument evidencing the obligation secured thereby, regardless of the number of instruments or the time of delivery or maturity of any such instruments, unless there is an express agreement for preference or priority. It is also provided that notices and deliveries by registered mail addressed to the last known address of a person shall be adequate. Additional provisions authorize agents to begin foreclosure sales, provided the power of attorney authorizing the agent to act is recorded, and authorize foreign representatives to act upon a mortgage in any manner necessary, after proper recordation of their appointment. This last provision was inserted to prevent the necessity of appointing ancillary administrators to enforce the terms of a mortgage loan of a deceased creditor in states other than that of the citizenship of the principal administrator.

[46] This article also defines certain criminal offenses and provides punishment therefore in connection with waste or other damage committed upon mortgaged premises.

[47] In addition to the members of the Subcommittee who participated in the discussion and drafting of this act, great credit is due Emery J. Woodall, Associate General Counsel, FHLBB, Thomas A. Sherman, Associate Counsel, HOLC, and James Aldrich Hall, Senior Attorney, FHLBB, for their valuable assistance.

For an excellent analysis of the proposed uniform act of the Subcommittee on Law and Legislation of the Central Housing Committee and a contrast of it with the 1927 draft of the National Conference of Commissioners on Uniform State Laws, see Legis., 86 *University of Pennsylvania Law Review* 517 (1938). For a short discussion of how existing foreclosure laws will probably prevent mortgage loans up to 90% of the value of property from being made under the FHA insured-mortgage program and how general adoption by the states of the Proposed Uniform Real Estate Mortgage Act would remedy the situation, see Bridewell, "Foreclosure Laws and Mortgage Loans," FHA *Insured Mortgage Portfolio* (July, 1938). For an analysis of another proposed mortgage act, see Fairchild, *op. cit.*

would greatly facilitate the flow of mortgage money across state lines, thereby reducing interest rates in states where demand for such money is greater than supply; and that it would in general avoid much useless trouble and expense now incident to home-mortgage lending and the foreclosure of mortgages.

A. Benefits to Mortgagors. From the point of view of mortgagors, general adoption of this Uniform Act should: (1) increase the maximum amount of a loan which a lending institution would be willing to advance and reduce interest rates because the risks of lending resulting from expensive, lengthy foreclosure proceedings and long redemption periods would be reduced to a minimum; (2) make more accessible mortgage funds because the resulting simplified procedure would facilitate the placing and handling of mortgages by large lending institutions operating on a nation-wide basis and the carrying out of the federal housing-credit program; (3) reduce foreclosure costs, which in the end are paid by or charged against the mortgagor or his property; and (4) reduce the cost of drafting and recording mortgage instruments, for which the mortgagor pays when he obtains a loan.

B. Benefits to the Mortgagee. From the point of view of mortgage-lending institutions, general adoption of the Uniform Act should: (1) facilitate the placing and handling of mortgages because of their shortness and the uniformity of the law which would thereby be achieved; (2) reduce administrative expense and risk because of the simple, inexpensive method of foreclosure and elimination of the redemption period; and (3) assure greater liquidity to their mortgage investments because the uniformity in the law should make such investments more salable and enable them to participate to a greater degree in the federal housing-credit program.

C. Benefits to the Public. From the point of view of taxpayers and the public general adoption of the Uniform Act should: (1) relieve courts of the routine court foreclosure proceedings, which would be handled administratively by power of sale in most cases, thereby giving the courts more time to discharge their other duties and keep abreast of their dockets; (2) reduce the amount of expensive fireproof space in public recorders' offices now required to preserve the records of the long mortgage instruments in common use; (3) eliminate the waste of money which now results from the present costly, time-consuming mortgage and foreclosure procedures and allow that money to be put to better use.

Urban Land Department

Morton Bodfish, *Editor*

The 1938 Revenue Act in Relation to Real Estate Operations

Real estate interests were not successful in obtaining in entirety the changes in the income tax law which they sought in the brief presented to the Congress through the agency of the National Association of Real Estate Boards. They did win substantial modification of the incidence of the income tax upon real estate operations.

Changes Requested

The Association asked two major changes, and offered certain alternatives:

1. Exemption from the definition of Personal Holding Company,[1] on the same basis as surety companies, of "an active bona fide [real estate] operating company engaged in the building, creating, developing and marketing of their products and properties reasonably necessary to the conduct of their business."

The alternatives offered, in case exemptions were not granted, were:

a. Exclusion of interest received on mortgage notes or contracts, obtained in the ordinary operations of an active bona fide operating company, from the definition of "personal holding company income";[2]
b. Reduction of the minimum proportion of rents to gross income for exemption from the definition of personal holding company income,[3] from 50 to 25%.

2. Permission to be extended to corporations generally as well as to personal holding companies to pay debts from earnings[4] without such earnings being subjected to either corporation surtax or personal holding tax when the debts so paid were contracted in good faith in the usual and ordinary way and in connection with the company's regular and usual business.

Specific Relief in the 1938 Act

Personal Holding Company. The Revenue Act of 1938 does not grant the exemption by definition from personal holding company classification. Briefly that definition is:

"any corporation if (1) at least 80% of its gross income for the taxable year is personal holding company income . . . [and] (2) at any time during the last half of the taxable year more than 50% in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals."[5]

Both these conditions must be met for classification as a personal holding company. The lightening of the tax burden upon real estate operations comes not through specific exemption of such companies, but through a restatement of the rent factor in the definition of the income of such companies.

Personal holding company income[6] means that portion of the gross income which consists briefly of:

a. Dividends, interest, royalties, annuities. . .
b. Gains from the sale or exchange of stock or securities; except in the case of regular dealers. . .
c. Gains from future transactions in any commodity on or subject to the rules of a board of trade or commodity exchange . . .
d. Gains from the sale or other disposition of any interest in an estate or trust
e. Amounts received under personal service contracts
f. Amounts received as compensation for the use of corporation property by a shareholder
g. Rents
h. Mineral, oil, or gas royalties.

The important concession is contained in clause (g) as follows:

(g) "Rents, unless constituting 50 per centum or more of the gross income. For the purposes of this subsection, the term 'rents' means compensation, however designated, for the use of, or right to use, property, *and the interest on debts owed to the corporation, to the extent such debts represent the price for which real property held primarily for sale to customers in the ordinary course of its trade or business was sold or exchanged by the corporation;* but does not include amounts constituting personal holding company income under subsection (f)." (Italics indicate new part of definition.)

In other words, when rents, including interest from real estate sales obligations, constitute 50% or more of the personal holding company gross income, the company no longer meets the first qualification of a

[1] Revenue Act of 1937, Title 1A, §352 (b).
[2] *Ibid.*, §353 (a).
[3] *Ibid.*, §353 (g).
[4] Revenue Act of 1936, Title A1, §§351 (b), 352 (b).
[5] Revenue Act of 1938, Title A1, §402 (a).
[6] *Ibid.*, §403.

personal holding company (see above). For, with 50% or more of the gross income excluded, the company obviously cannot meet the 80% requirement. As a result of this change in the law, classification of a real estate company as a personal holding company is prevented in those years when real estate operations are inactive, and income consists largely of interest on obligations in connection with sales of real estate.

Debt Relief. The second major contention of the National Association of Real Estate Boards was substantially granted under a redefinition of "Corporation Dividends-Paid Credit" with respect to debt retirement. The new clause is as follows:

"Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness. As used in this paragraph the term 'indebtedness' means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest."[7]

A similar clause in the 1936[8] Act restricted relief credit to amounts actually paid or irrevocably set aside pursuant to the requirements of a contract. The current law does away with the contractual requirement, except that there must be some instrument as evidence of the debt.

Capital Gains and Losses

There is some direct advantage to real estate operations also from the rewriting of the section taxing capital gains and losses of individuals. Corporations do not come under the percentage provision applicable to individuals.

Individuals.[9] The capital gains and losses of an individual are to be divided into two classes. In the short-term classification of gains and losses are those resulting from sale or exchange of property held for not more than 18 months. Long-term capital gains and losses are those from the sale or exchange of capital assets held for more than 18 months. Net gains in the first instance are taxable at 100%. If there be a short-term capital net loss for any year—that is, an excess of short-term taxable loss for the taxable year over short-term capital gain for the year—the loss may not be deducted from ordinary income, but must be carried forward and applied against the short-term capital gains of the succeeding taxable year.

In other words, if short-term losses are in excess of the short-term gains, the taxpayer does not benefit through deduction of the excess loss from net income and does not have the additional $2,000.00 allowed. He is allowed merely the net excess of losses over gains, to be carried over to the following year.

In the case of a taxpayer other than a corporation, only the following percentages of the gains or losses are recognized and are to be taken into account in computing net income. If the assets have been held for 18 months or less, 100% of the income on this basis is taxed. If the assets have been held for more than 18 months but not more than 24 months, only 66⅔% of the income is taxable. If the assets have been held for more than 24 months, only 50% is taxable.

With regard to long-term capital gains, the method of adding capital gains to the tax base is this:

a. Add them to ordinary income and arrive at the total tax;
b. Take all income except long-term gains, and compute the tax thereon, to which is to be added the tax on the recognized long-term gains at the rate of 30%, showing total tax liability;
c. Pay whichever of the foregoing tax computations is the lesser.

The rule boils down to this: That if the assets are held for 18 months or less, the taxpayer pays as upon ordinary income; if the assets are held for more than 18 months and less than 24 months, the tax rate is 20%; and if the assets are held for over 24 months, the rate is 15%; but with the proviso regarding long-term capital gains, that if, on the basis of these percentages added to regular income, the tax would be more than would be paid at regular rates, only the lesser amount be paid.

With respect to net long-term capital losses, there is an alternative method of computation, and the *higher* tax resulting

[7] Revenue Act of 1938, Title I, §27 (a) (4).
[8] Revenue Act of 1936, Title I, §26 (c) (2).
[9] Revenue Act of 1938, Title I, §117.

from the two methods of computation must be reported. The procedure is as follows:

a. Compute the tax on net income after deducting long-term loss in the regular manner;
b. Compute the tax on the net income increased by the long-term capital loss in the regular manner, and then reduce such partial tax by a 30% tax on the recognized long-term capital loss, reflecting the net tax liability;
c. Report the higher tax liability as reflected by the two methods.

The Timing Factor. Capital gains and losses offset each other to determine the net gain or loss, but the items are individually subject to the limitations of 66⅔% and 50%, depending on the time held, in determining the admissible gain or loss. The gains and the losses should, therefore, be segregated from other income, and each item classified according to the time held.

The decision voluntarily to take a capital gain or a capital loss turns upon a predetermination both of the relation of the prospective gain or loss to the surtax, and of the effect of the percentage limitation in determining the net gain or loss. The operation of the limits in any particular case may be to turn an actual gain or loss into a net loss or gain for tax purposes, or materially to increase an actual gain or loss for tax purposes.

Corporations.[10] Net capital gains are fully taxable. Capital losses are deducted to the extent of $2,000.00 plus any capital gains. There is a provision, however, that those assets which are used in the business and which are subject to depreciation are excluded from the capital gains definition. So that now, if a piece of equipment be sold for more than its depreciated amount, the gain becomes part of ordinary income.

On the other hand, if there be a net loss, it may be taken as a deduction like any other operating expense, and not subjected to the $2,000.00 limitation.

Corporation Taxes

The normal and surtax rates on individuals have not been changed.[11] Important changes have been made, however, in the corporate tax schedule which will benefit real estate companies as well as other corporate businesses. Following is the general schedule:[12]

Corporations with Earnings of $25,000.00 or Less pay no undistributed profits tax. They pay only a normal tax as follows:

Income	Rate
On first $ 5,000.00	12½%
On next 15,000.00	14 %
On next 5,000.00	16 %

On $25,000.00 even, the total tax would be $3,525.00 or an average tax rate of 14.1%.

Corporations Earning over $25,000.00 are given alternative methods of computation, with directions to use the method which yields the lower tax. The tentative tax rate is 19% of the adjusted income (net income less credit for interest on obligations of the United States and government corporations). The tax is then reduced by two credits:

1. 16½% of the dividends-received credit
2. 2½% of the dividends-paid credit

but this 2½% credit may not exceed 2½% of the adjusted net income. The remainder is the tax.

Corporations Earning Slightly over $25,000.00 will compute their tax by one of the following methods:

1. General basis for corporations earning over $25,000.00; or
2. Tax on first $25,000.00 as computed for corporations with incomes of $25,000.00 or less, plus 32% on the excess over $25,000.00, except that the rate is 12% on any dividends received which is a part of the income in excess of $25,000.00.

Exceptions. The tentative 19% tax under the general rule in the foregoing is reduced by 2½% of the adjusted net income, instead of 2½% of the dividends-paid credit, in the case of:

Corporations in bankruptcy and receivership
Joint-stock land banks
Rental housing corporations[13]

and certain other special classes of corporations, such as banks and insurance companies.

Excess Profits and Capital Stock Tax.[14] The rates remain the same as they were under the 1936 Act—that is, 6% of that proportion of the net income in excess of 10% of the de-

[10] *Ibid.*
[11] *Ibid.*, §§11 and 12.
[12] *Ibid.*, §13.
[13] *Ibid.*, §14. "Rental housing corporation" as used here is one which is regulated and restricted under §207 (b) (2) of the National Housing Act.
[14] *Ibid.*, Title III, §§601, 602.

clared value and not in excess of 15%; and 12% of the net income in excess of 15% of the declared value. A new provision, however, permits a *new adjusted declared value to be made in July, 1938, and thereafter new value may be declared every three years.* It is most important that advantage be taken of this clause, in order to obtain proper credit for excess profits tax for income and excess profits tax returns to be filed for three years closing after June 30, 1938.

Surtax on Improper Accumulation of Surplus.[15] The rate for the first $100,000.00 of retained net income has been increased from 15 to 25%; and the rate on retained net income over $100,000.00 has been increased from 25 to 35%. There are some adjustments for personal holding companies.

The new tax law also places *the burden of proof upon the taxpayer, to show "by clear preponderance of the evidence"* that there is no improper accumulation beyond the needs of the business.

Dividend Carry-Over.[16] There is a "dividend carry-over" provision for the two preceding years. If more dividends were declared than there were earnings, the credit may be carried forward for a period of two years. Excess dividends may be carried over from as far back as 1935.

Personal holding companies are allowed a dividend carry-over in computing the dividends-paid credit for the purposes of the surtax imposed on holding companies. This was not allowed under the 1936 Act.

Deficits.[17] There is allowed as part of the dividends-paid credit the excess of any deficit in accumulated profits at the close of the preceding fiscal year.

Consent-Dividends Credit[18] means that, if all the stockholders agree to be taxed on their distributable share of the earnings, the total may be deducted by the corporation as if the sum actually had been paid.

Credit for Net Operating Loss[19] carried forward from the preceding taxable year, which enters into computation of the basic surtax credit, is not applicable to any taxable year beginning before January 1, 1939. Therefore, any loss in 1937 cannot be deducted from the 1938 return, but any loss in 1938 may be deducted from the 1939 return.

Dividends Paid.[20] Dividends-paid credit is applicable not only for computation of the income on corporations under the general rule set forth, but also for the purpose of the surtax on improper accumulation, and of the surtaxes to personal holding companies. It has a wider application than to the undistributed profit tax provision alone.

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[15] *Ibid.*, Title I, §102.
[16] *Ibid.*, §27 (c).
[17] *Ibid.*, Title I, §27 (a) (3).
[18] *Ibid.*, §28.
[19] *Ibid.*, §26 (c) (2).
[20] *Ibid.*, §27 (a) (b).

The Constitutionality of Federal Savings and Loan Associations

THE creation of federal savings and loan associations, as provided in Section 5 of the Home Owners' Loan Act of 1933 as amended,[1] was held to be a valid exercise of the constitutional power by the Congress in a decision rendered by the United States Circuit Court of Appeals, Seventh Circuit, on May 20, 1938.[2]

In an able and well considered opinion, the majority of the Court decided that, even though the Constitution of the United States does not, of course, expressly empower Congress to establish savings and loan associations, their creation should be sustained as a valid exercise of the fiscal power of the Federal Government derived by implication from the express powers granted to the Congress and also as a valid exercise of the express power granted by the general welfare clause in Article I, Section 8, clause 1 of the Constitution.

A learned dissenting opinion was written which discusses at considerable length the respective interpretations of the general welfare clause by Hamilton and Madison and, should this case reach the Supreme Court of the United States, a most interesting question will be presented for consideration by that distinguished Court. Briefly stated,

[1] 12 U.S.C.A. §1464.
[2] *First Federal Savings and Loan Association of Wisconsin v. Loomis, Attorney General, et. al*, No. 6381.

that question is whether Congress in creating federal savings and loan associations, which are an integral part of the home-financing structure of the United States relatively equivalent to national banks in the banking structure in our nation, has validly exercised its powers under the Constitution of the United States. But in the present discussion, the economic implications of the decision rather than the legal aspects of the question are of primary interest.

Congress in 1932 created the Federal Home Loan Bank Board which now has 12 regional federal home loan banks under its jurisdiction. Thereafter, in 1933, it created federal savings and loan associations in the same Act which established the Home Owners' Loan Corporation. Finally, in 1935, it set up the Federal Savings and Loan Insurance Corporation.

These respective institutions, although they are concerned principally with giving stability and permanence to home financing, are roughly analogous to the Federal Reserve Board, the national banking system, and the Federal Deposit Insurance Corporation.

No serious attack, constitutional or otherwise, has been made on any integral part of the federal home loan bank system excepting only federal savings and loan associations.

In these days of economic doubt, it is indeed both inspiring and reassuring to those who believe that the American home is the foundation of our liberties to have the majority of the court say in the opinion:

> "To our mind the preservation of home owners and the promotion of a sound system of home mortgage is none the less national in scope than the provisions for the unemployed and the aged. Its scope, as affecting the welfare of the nation as a whole, is of equal importance. To say that Congress has the authority to make provision for one class and not the other is to make a distinction justified by neither logic nor common sense. The problem presented in one case is no less national in its aspect than that presented in the other."

While the majority opinion alludes to but does not stress the point, it is a matter of common knowledge that home financing in the United States, together with many other types of financing, came perilously near to complete collapse. The creation of federal savings and loan associations has been of great and as yet unmeasured importance in the saving of and the revival of the home-financing structure in this nation. This it has accomplished through several distinct effects.

In the first place, many state institutions engaged in home financing had, in part at least, lost their prestige and no longer enjoyed that confidence which is absolutely essential to the continuance and success of any financial institution. Those with sound, if frozen, assets and capable management were generally given the opportunity, which many accepted, to convert into federal savings and loan associations, and in most cases were enabled not only to save themselves from extinction but to get back rapidly on the path of real service to the borrowing and investing public alike.

Second, and equally important, through the creation of federal savings and loan associations many sections of the United States were given a real opportunity for the first time to establish home-financing institutions based on sound economic principles, where the function of accepting investments to be loaned to persons desiring to finance homes was the principal purpose for existence, and not merely incidental to some other function or functions regarded as of primary importance.

Third, for the first time in the economic life of the nation, a uniformity was provided in home financing which made the words "savings and loan" mean the same identical thing everywhere if the word "federal" preceded the title. No longer need the citizen of one state where "savings and loans" operate as first mortgage institutions remove to another state and invest his savings only to learn eventually that his funds were there loaned on the hazardous security of junior liens.

Finally, in a nation where uniformity of laws among 48 states is most difficult to achieve even after years of intensive effort, it has been possible through the establishing of federal savings and loan associations to effect within a relatively short time the adoption generally of better practices in home financing.

The creation of federal savings and loan associations is justified economically if nothing more is ever accomplished thereby than the resultant wide acceptance of the direct-reduction mortgage loan plan which had been theretofore used only in New York, Ohio, and a few other states. The borrower

of funds to finance his home is entitled to know definitely the balance owed by him at any given time. He is likewise entitled to know that, if he makes regular payments in a given amount over a specific period, his debt will be paid in full. Under the share-account, sinking-fund mortgage loan plan in general use by savings and loan institutions prior to creation of federals, where the retirement of the loan was contingent upon shares in the institution maturing through payments thereon plus the accumulation of dividends on such shares, the balance due on a loan could only be determined by expert calculation, and could even then be no more than a guess, as has been tragically proved during the past few years of economic uncertainty and distress.

So it seems fair to conclude that, whatever their status may be determined to be legally, the creation of federal savings and loan associations has been beneficial to the investing member and the borrowing member as well as to the citizens of this nation as a whole.

If the decision of the court becomes final, or if the Court of last resort sustains the opinion, it is only fair to assume that "savings and loan" institutions created by Congress and those created by the several states can operate side by side in their respective communities in a spirit of friendly competition, wholesome cooperation, and mutual respect to the ultimate benefit of both types of institutions. State and national banking systems have long since achieved this result and there is no logical reason to presume that home-financing institutions cannot do likewise.

So, in final analysis, Congress in creating federal savings and loan associations has opened up perpetually to the United States Government another great nation-wide reservoir of credit, provided systematically by thrifty, home-loving people, which can be drawn on with confidence through the sale of Government obligations if a period of need may ever come, whether that be in time of war, or, as we most ardently hope, only in times of peace.

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"Low-Cost Housing"—1938 Model

IN ITS closing hours the final regular session of the 75th Congress enacted legislation embodying the President's program for an immediate grant of nearly four billions of dollars to be distributed as additional emergency relief. The law which was signed on June 21 was the climax of a series of appropriations during this session which aggregate the unprecedented total of approximately 12 billions of dollars. Incorporated as part of the general relief measure (H.J. Res. No. 679), as it finally emerged from the conference discussions between Senate and House, was a section into which were condensed some of the principal features of the several bills introduced early in the session to amend the controversial Wagner-Steagall United States Housing Act of 1937. It had been attached as a "rider" in the Senate to the general relief measure after passage of the latter in the House. This meant that it could only be dealt with by the conferees on the part of the two branches, and could neither be considered nor debated on the floor of the House. This was significant, in view of the critical, if not hostile, attitude of some of the influential members of the House toward the activities of the United States Housing Authority, and of their disposition to challenge whether the entire public-housing program was really designed to clear slums and remove blighted areas, or was merely aimed at the erection of Government-subsidized, low-cost housing.

It will be recalled that the first section of the 1937 law declared it to be the policy of the United States to promote the general welfare by employing its funds and credit to assist the several states and their political subdivisions to *alleviate present and recurring unemployment* and to remedy the unsafe and insanitary housing conditions and the acute shortage of decent, safe, and sanitary dwellings for families of low income.

Briefly stated, the 1938 amendments to the original statute, provide:

1. For increasing the limit of annual contributions made by the USHA to local public-housing agencies and designed chiefly to furnish federal subsidies to assist in achieving and maintaining schedules of low-rentals on public projects. These were originally on a graduated yearly scale between $5,000,000 and $7,500,000. They are now fixed at $28,000,000 annually. The Administrator, Mr. Nathan Straus, had asked for yearly contributions of $50,000,000.

2. An increase of the original maximum bond authorization to be used as the basis of loans and grants, by adding the $300,000,000 specified by the President. The upper limit is thus fixed at $800,000,000 instead of the $500,000,000 first authorized, while the restriction as to spacing the issuance of these obligations over a three-year progressive schedule is now eliminated. The maximum maturity date of 60 years and the limitation of interest, not to exceed 4%, have been retained in the amendment and made applicable to the increased bonding power now authorized.

The bills drafted by the Chairmen respectively of the House and Senate Banking and Currency Committees, for consideration at the time it was expected to adopt further separate legislation to deal with slum-clearance and public housing, contemplated supplementing the ultimate bonding limit by raising it to a billion dollars.

In the President's special message to the Congress of April 14, 1938, in which he advocated sundry emergency items with which to stem the tide of business recession, he specifically urged as to public housing:

"certain amendments to the United States Housing Authority Act to permit the undertaking of the immediate construction of about $300,000,000 of additional projects. The Federal Housing Administration is prepared to increase the already mounting volume of home and apartment construction."

Adoption of the presidential proposal indicates that the Federal Government is becoming more and more committed to the assumption of a continuing and avowed obligation to provide, by one device or another, for the permanent "domiciliary care" of a large class of its citizens, loosely estimated as ⅓ of our population, who are allegedly occupying so-called "slum" or substandard housing and are professed to be unable to provide themselves with decent, safe, and sanitary housing facilities without some form of aid through governmental subsidy. This new philosophy, it should be noted, reverses the traditional belief that providing for, and regulating, the housing of America's inhabitants was a problem which should be within the province of and of concern to local governmental bodies exclusively.

How rapidly the machinery can be perfected for translating this latest legislation into an actuality, by which to rehouse any considerable number of people, remains to be seen. At the time the President urged this extension of its powers, the USHA had been in existence nearly eight months. It was vested with adequate power to conclude grants and issue bonds in the furtherance of slum-clearance and public-housing projects to the extent of $100,000,000 during the fiscal year ended July 1, 1938. Up to that time, however, no money had been paid out nor projects commenced, although the Administrator, Mr. Straus, later announced that some $310,000,000 had been "earmarked" for projects to be started during the coming year.

In fairness to the Housing Authority, it should be recognized that in the early months of its existence much of the work consisted in taking over the housing and slum-clearance projects which under the 1937 Act were transferred from the housing division of the PWA, conceived under relief legislation as a part of the earlier emergency legislative program following the 1929–1933 depression. Also the new organization was confronted with the immediate necessity of procuring supplemental enabling legislation from state and municipal law-making bodies, whereby local housing authorities may be created as the means of making funds available to the local beneficiaries of the projects authorized under the United States Housing Act. Moreover, the validation of tax exemptions or remissions of taxes, perforce operating as vital elements in most cases, toward the requisite participation by local communities in matching the federal annual contributions has proceeded slowly because of constitutional impediments. These preparatory activities, as well as the necessity of organizing the required staff of experts and technicians to handle the nation-wide operations of the Authority, virtually consumed the interval from September 1, 1937, well into the present year.

Adequate local legislation at the hands of the states is imperative because the statute specified that not more than 10% of the available housing credits should be allocated to any single state. This limitation was not altered under the recent amendment.

In spite of these circumstances in extenuation of the negligible results of the eight months' work of the USHA and in spite of the fact that the best interests of the long-range program called for much careful preliminary preparation, decided disappointment was expressed in committees and on the floors of the two houses of Congress concerning the results so far attained in relation

to the capital expenditures authorized and the sweeping powers conferred by the original legislation.

It is recognized that the continued existence in our cities of slums and blighted areas constitutes a menace to the general welfare, as well as a serious economic drain on the community in the form of fire hazards, breeding places for disease and crime, and make for a generally lower type of citizenship. Aside from these considerations, the tolerance of such living conditions for any part of our population is repugnant to all humanitarian ideas of a civilized social order. But it is also true that the spread of deterioration from blighted neighborhoods cannot be arrested by small-scale rehousing and slum-clearance projects. For the latter are only engulfed in the tide of further decay.

The question is, how best to deal with so complex a problem and through what agency of organized society can it best be handled?

Since the effects of the slums, economic, social and physical, are felt directly and immediately by the local communities of which they are a part, it would seem logical to assume that these local communities are the most concerned and that they are the most effective instruments of correction.

Whether a Federal Government agency can cope with the problem on a nation-wide scale, and not only eliminate all existing slums but meet the ever-continuing demands of obsolescence and deterioration which in time create new slums, is a question which only time can answer. The USHA is probably equipped to provide about 150,000 family units during the next three years, which means one million such accommodations over a term of 20 years. If the estimate of 5,000,000 families now living in "substandard" housing is accepted and if, during the next 20 years, it is granted that normal population growth and other conditions, will increase the number of families in need of subsidized housing to 10,000,000, it can readily be seen that the Authority's activities will hardly scratch the surface of the real needs of the country in eliminating urban slums and blighted areas.

At least, an attack has been made on the problem. Under intelligent direction it may go far to pointing the way to its better solution, if only by the "trial-and-error" method. It may well be that only in this way can an answer be found to the question of whether this, or indeed any Federal Government agency, can effectively deal with so vast and complex a problem, essentially local in nature, in the best interests of all concerned.

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Texas Farm Tenure Activities

Character of Texas Tenancy

FARM tenancy in Texas has some of the characteristics of both the Old South and the Middle West. In common with both these areas the trend of tenancy, except during the short interval from 1930 to 1935, has been upward during the entire period of recorded tenancy statistics. In 1880, 37.6% of the 174,184 Texas farms were operated by tenants. Between 1880 and 1935 the number of farms in Texas increased 188% while the number of tenant farmers was increasing from 65,468 to 286,403, or 337%. In 1935, over ½ (57.2%) of Texas farms were operated by tenants. Like the Old South, Texas tenancy is largely cotton tenancy; and to a smaller extent, share-cropper tenancy. Of the 349,452 cotton farms in Texas in 1935, 69.5% were operated by tenants. However, only about ¼ (26.7%) of the tenants in Texas were share-croppers, and only ⅓ of the share-croppers were Negroes. Like the western states to the north, Texas has a relatively large group of capable, well-fixed tenants who have made farming a moderately profitable enterprise. These tenant farmers quite frequently operate large farms with tractors and as a consequence enjoy incomes and standards of living equal to or above those of neighboring farm owners. Unlike either the Middle West or the South, Texas has a large and rapidly growing Mexican tenant and farm labor population—a situation which complicates landlord-tenant relations.

The predominating leasing system in Texas is based upon unwritten, customary agreements and is popularly known as the "third-and-fourth" system. Under this system a tenant furnishes workstock and machinery, pays nearly all production expenses, and pays as rent ¼ of the cotton and ⅓ of the corn, grain, and other feed crops. The landowner furnishes the land, improvements, and pays his share of the insect poisons, ginning and threshing tolls. The second most important system of renting land in Texas is the half-and-half, or share-cropper system, whereby the tenant furnishes only the labor and receives as his share ½ of all crops grown. The share-cropper is essentially a farm laborer. In Texas, however, some share-croppers, especially many of those not living on plantations, exercise almost as much management and control in operating the farm as if they were "third-and-fourth" tenants.[1]

These rental systems have many variations. Under present conditions a very large number of the share tenants pay cash rent for feed and pasture land. In addition to this cash rent, reports indicate that some tenants, in order to get or keep a farm which they want, will pay a cash bonus in advance. The amount of "bonus" rent is very difficult to determine because considerable stigma has grown up around the bonus system. Tenants, it is said, will not report bonus rent because they are afraid of losing possession of their farms. Because of decreasing cotton acreage and the consequent changes in type of farming, the combination of the share and cash systems seems to be growing.

Recent Trends in Texas Farm Tenancy

Reduction in cotton acreage, mechanization of farms, increase in absentee landowners, the soil conservation movement, diffusion of livestock farming, and several related factors are operating to bring about far-reaching changes in the Texas farm tenancy situation. The first and most important change to be noted is the decline in number of farm tenants, particularly of share-croppers, in cotton-growing areas. Between 1930 and 1935 the number of share-croppers in Texas declined from 105,122 to 76,468, or approximately 27%. True, the number of renters did increase 6.7% during the same period, but this increase was not in the large cotton-growing areas.

Since 1935 the number of tenants in cotton-growing areas, because of farm mechanization, has likely declined considerably more. From 1935 to 1937 the number of tractors on Texas farms increased about 75%, the number in 1937 being ap-

[1] Locally, share-croppers are called "half-hands" or "halvers," while all other tenants are called renters.

proximately 100,000.[2] Further evidence of accelerated displacement of farm tenants is found in the report of farm population changes in Texas during 1937. This report indicates a decrease of something like 20,000 farms in Texas during 1937 and a net loss by migration from farms to cities of about 46,000 people. Many of the displaced farmers, possibly ½, have remained in rural areas either as farm laborers or as unemployed persons.[3] In one respect, farm mechanization in Texas will be constructive. By that I mean that farms will be larger and, as a consequence, tenant farmers will be of a more responsible and stable character.

The increase in absentee landowners is bringing about an increase in the use of and demand for written leases. Many absentee landowners, it has been found, are taking more interest in modern soil conservation methods and are developing written leases which incorporate such features. The trend toward livestock farming is creating a demand for livestock leases and, as already said, is increasing the number of share-cash contracts. The Experiment Station is making a careful study of existing livestock leasing practices in Texas; and, at the same time, is placing in the hands of interested farmers approved livestock leases from other states. In order to determine the nature of livestock leases needed, the use of livestock leases by Texas farmers is being carefully studied.

The increased attention now being given to soil conservation has also created a need for leases which will set out clearly the duties of landowner and tenant in soil conservation work. The fact that many farm owner-operators have been just as delinquent as tenants in the matter of soil conservation does not mean that a proper leasing system would not be of great value in promoting soil conservation on tenant farms.

The Farm Lease Study

Realizing that adjustments in farm tenure must be based on a solid foundation of fact as well as principle, the Texas Agricultural Experiment Station began in 1936 a comprehensive study of the problems of farm tenure and farm leases.[4] The primary objective of the study is to determine the kinds of leases best adapted to the different types of farming in Texas. The objective of the study has been broadly interpreted to include the social as well as economic aspects of the subject. One of the first questions which we put to ourselves, therefore, was:

"By what criteria should existing and proposed leasing systems be tested?" After considerable study, it was decided that any leasing system should be expected to:

1. Permit and promote an efficient use of human and natural resources;
2. Provide for a fair and equitable distribution of farm income between landowners and tenants;
3. Encourage the proper care and improvement of farm land, improvements, and other permanent farm capital;
4. Promote security of tenure and of income;
5. Promote an economic system of credit, marketing, and other business relations;
6. Result in peaceful, harmonious relations between landowner and tenant;
7. Make possible and encourage a decent standard of living for landowners and tenants;
8. Promote good citizenship and a satisfying community life.

Needless to say, no leasing system should be expected to have the sole responsibility in reaching these objectives. It is our assumption, however, that a leasing system does have a very important and distinctive contribution to make. So interrelated and interdependent are all these things with the leasing system, that all discussion as to which one is the most important becomes superfluous.

Landowner and Tenant Incomes

The first project undertaken was an analysis of approximately 600 farm records representing farms in four major types of farming areas—namely, the Northeast Sandy Lands, the Black Prairie, the Low Rolling Plains, and the High Plains Cotton Area.[5]

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[2] This estimate is based upon the increase in number of farmers making claims for gasoline tax refunds, and upon the estimate made by the *Farm Implement News*, April 7, 1938.

[3] These data are based upon the annual survey of population movements made by the Texas Agricultural Experiment Station in cooperation with the U.S. Dept. of Agriculture. The report, "Farm Population Changes During 1937" may be obtained from the Texas Agricultural Experiment Station.

[4] In this study the Texas Agricultural Experiment Station has had the cooperation of the AAA, FSA, and WPA.

[5] The study was based upon survey records in the

(*Footnote 5 continued on page 332*)

Among other things, the study reveals that tenant farmers in all areas pay about ⅓ of the *net* cash receipts and about ¼ of the *net* farm income as rent.[6]

The percentage of net income paid as rent has no apparent relation to size of farm or productivity of the land, although net income itself is, as would be expected, highly correlated with such factors. The average net farm income in the East Texas area, for instance, was $353. Of this amount, $267, or 76%, was tenant income; and $86, or 24%, was landowner income. In the Black Prairie Area the average net farm income was found to be $1,137. Of this amount, $870 or 76% was tenant income, and $267 or 24% was landowner income. In other areas the average percentage of net income received by the tenant varied from 64 to 79%. It may be concluded, but not definitely proved, that the "third-and-fourth" share-rent system is not as flexible as it appears to be or perhaps as it might be. If the share-rent system is rigidly adhered to, it seems that on very productive lands the landlord would collect something less than *economic* rent and that the reverse would be true on unproductive lands. This situation helps to explain why a few landowners on the better lands of central and west Texas are getting, in one form or another, a *bonus* rent above the regular third-and-fourth shares.[7]

A second important conclusion growing out of the income studies relates to that part of the farm income which is not shared with the landowner. From ¼ to ⅓ of the gross income, on purely share-rented farms, may be classed as non-shared income. This non-shared income is mainly of two kinds: (a) tenant family living from the farm—a non-cash item; and (b) the sales of livestock and livestock products—a cash item. Under the present leasing system it is to the tenant's interest to expand these sources of income but to the landowner's interest to keep them from expanding too far. Recent events—mainly reduction in cotton acreage—have brought about an increase in farms producing livestock and livestock products and hence an increase in farm income which is not customarily shared with landowners. This development together with the already existing need for more tenant income suggests that leases are needed which will encourage a desirable amount of live-at-home farming as well as livestock production for the market. These two things go together because a very large percentage of farm products consumed by farm families are livestock products.

Other Subjects Studied

With the cooperation of the FSA and the AAA surveys have been made of approximately 1,000 farms in the same areas where the income records were available. The chief purpose of these surveys is to determine the relation of farm leasing practices to: farm organization, soil conservation, length of tenure, settlement of differences between landowners and tenants, standards of living, and rural institutions. A separate study is being made of the legal aspects of farm tenure in Texas.[8] The results of these surveys are not yet available.

An Experimental Lease

In the course of the study it has become increasingly evident that there is a definite need for improved rental agreements. Many types of rental contracts have been found—some good, some bad, and some indifferent. Very few written contracts now in use make any positive contribution to solution of the real problems of leasing farm land. The great majority of written contracts include little more than the minimum legal essentials and, for the most part, deal with the division of farm crops, payment of rents, and

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(*Footnote 5 continued from page 331*)
Northeast Sandy Lands and in the Low Rolling Plains, but on farm account book records in the other areas. For further information about these areas see Bonnen, C. A. and Thibodeaux, B. H., "A Description of the Agriculture and Type of Farming Areas in Texas," Tex. Ag. Exper. Sta. *Bulletin* No. 544.

[6] *Net farm income* represents the returns to land, operating capital, and to operator's labor and management. Such non-cash items as *living from the farm* and increase in inventory have been counted as income; and the value of unpaid family labor and decrease in inventory have been counted as expenses or deductions.

[7] Occasionally a case may be found where an owner of good land is charging 1/3 of the cotton as rent. On the other hand, few cases have been found where owners of relatively unproductive lands were asking only 1/5 of all crops as rent. These isolated cases suggest that a plan might be worked out where, over wide areas, the shares charged as rent might be made to vary with productivity of the land.

[8] Under the leadership of Marshall Harris, Division of Land Economics, Bureau of Agricultural Economics, U.S. Dept. of Agriculture.

various responsibilities of the tenant. Such leases make practically no contribution toward encouraging longer periods of tenure, soil improvement, improvement of farm buildings, live-at-home farming, livestock farming, and arbitration of landowner-tenant differences.

It appeared, therefore, that a general farm rental agreement could be drawn up which would incorporate the best features of contracts and unwritten agreements now in use, as well as a number of provisions which were recommended by the President's Committee on Farm Tenancy. The Division of Farm and Ranch Economics drew up such an experimental agreement and submitted it to numerous farmers and agricultural leaders for suggestions and criticism.[9] The "experimental farm rental agreement" has attracted considerable attention and in a modified form is already being used by a number of landowners.[10]

Outlook for the Farm Tenure Program

Interest in farm tenancy is not at all new in Texas. Texas farmers and agricultural leaders have been concerned over farm tenancy for many years. In 1915 Dr. G. S. Wehrwein, then at the University of Texas, was recommending:

> "... a careful study of the situation and the development of a system of rent contracts which will lead toward greater permanency in land tenure and the introduction into the contract of constructive terms concerning both temporary and permanent improvements upon the land. Land leases which will embody features of this kind cannot be written offhand nor without a scientific study of the character of the farm and the personal relationship between the landlord and the tenant."[11]

Also in 1915 a state law was enacted limiting the amount of rent to the customary "third-and-fourth."[12] This law was later declared unconstitutional;[13] but a similar law was passed in 1931 which, in effect, gave a landowner a lien on the tenant's crops to insure payment of debts and rents to the landowner, except that such a lien would be invalid where the landowner charged more than the customary "third-and-fourth" rent.[14] Neither of these laws has had appreciable effect on the leasing systems of Texas.

Other and more recent evidence indicates that a large and growing body of people in Texas want to "see something done" about farm tenancy. Something would have been done long ago if those interested had known what needed to be done and how they should go about it. As a result of past failures, there is a growing conviction that the solution of tenancy problems is not a simple task. Farm tenants cannot be made into farm owners over night. Neither can the lease problem be solved by passing a few simple laws. The public must first see what the real problems of tenancy are and then they will support a constructive program for solving those problems.

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Division of Farm and Ranch Economics,
Texas Agricultural Experiment Station

[9] This agreement has been mimeographed as Texas Agricultural Experiment Station Progress Report No. 478, "An Experimental Farm Rental Agreement." It is now being revised and will be published in a more permanent form at an early date.

[10] A similar lease drawn up by the FSA has also received wide circulation in the State.

[11] "Studies in Farm Tenancy in Texas," University of Texas, *Extension Bulletin* No. 21, 1915.

[12] Texas Acts 1915, p. 77.

[13] 118 Tex. 491; 18 S.W. (2d) 585 (1929).

[14] Texas Stats. (Vernon, 1936), Art. 5222; Texas Acts 1931, c. 100, §1, p. 171.

Recent Progress in the Enactment of Rural Zoning Enabling Legislation

THIS note will treat state legislative activity for rural zoning during 1937 and the early part of 1938, a period which covers an entire cycle of legislative sessions.[1] The most important rural zoning legislation coming into force during this period, from the point of view of comprehensiveness and area affected, was that enacted in Pennsylvania, comprising a general county enabling act and a second-class township enabling act.[2] Since the Pennsylvania statutes have been treated in some detail in a previ-

[1] Excepting Louisiana, the legislature of which does not convene in regular biennial session until May 9, 1938.

[2] Acts Nos. 435 and 504 (1937).

ous issue of this *Journal*, they will not be further discussed here.[3] Discussion of the Tennessee enabling acts, applying to the five counties in the extreme northeastern part of that State, will for the same reason likewise be omitted.[4] There remain then principally the Virginia county act, several items of Georgia legislation, the amendments to the California county planning act, the Michigan township enabling statute, the Dade County (Florida) act, and an Indiana act directing the state planning board to prepare a draft highway zoning bill.

Georgia

As far back as 1925 special zoning enabling acts applying to specific counties were enacted in Georgia, designed however to apply to urban or semi-urban rather than purely rural situations.[5] But these acts, with the exception of the Fulton County Act, were rendered invalid by a Georgia Supreme Court decision in September, 1936, which held that a constitutional amendment would be a prerequisite to any county zoning enabling legislation.[6] Two such amendments were in due course proposed by the Legislature and favorably received by a majority of voters of the State at a special election on June 8, 1937.[7] These amendments provide, among other things, that the Legislature be empowered to "grant to the governing authorities of any City or County in this State having a population of 1,000 or more . . . the authority to pass zoning and planning laws." Pursuant to this new constitutional grant of power, an extraordinary session of the Legislature has passed four special enabling acts, which together authorize zoning in Glynn, Chatham, Bryan, Liberty, Cobb, DeKalb, and Richmond Counties.

The fullest of these is the act applying to Glynn County.[8] It empowers the Commissioners of Roads and Revenue (i.e., the county board of supervisors) to adopt and enforce zoning regulations in the unincorporated areas of that County, to control the height, use, etc., of buildings, set-back lines along the highways, and the use and occupancy of land "for trade, industry, residence, recreation, agriculture, grazing, water supply conservation, soil conservation, forestry or other purposes." By and large, with exceptions herein noted, this act follows the illustrative draft contained in Land Use Planning Publication No. 10,[9] which in turn was an adaptation of the widely followed Standard State (municipal) Zoning Enabling Act prepared some years ago under the auspices of the Department of Commerce. One interesting feature was borrowed from the Pennsylvania County Enabling Act—namely, that the zoning ordinance may

> "provide for the termination of non-conforming uses, either by specifying the period or periods in which non-conforming uses shall be required to cease, or by providing a formula or formulae whereby the compulsory termination of non-conforming uses may be so fixed as to allow for the recovery or amortization of the investment in non-conformance."

A brief section provides for general planning activities, not necessarily pointed to zoning;[10] and another, for control, exercised by the Commissioners of Roads and Revenue with the advice of the Planning Board, over the laying out of new streets and roads and over the character and location of water mains and sewers in new subdivisions.

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[3] V. Hurlburt, "Pennsylvania Planning and Zoning Enabling Acts," this *Journal*, August, 1937, pp. 313–7.

[4] James H. Marshall, "Rural Zoning Legislation in Tennessee," this *Journal*, November, 1937, pp. 418–20.

[5] Counties having not less than 200,000 population, Acts 1925, p. 337; Glynn County, Acts 1927, p. 602; Chatham County, Acts 1927, p. 521; Fulton County, Acts 1927, p. 591.

[6] *Commissioners of Glynn County v. Cate*, 183 Ga. 111. The specific question before the court was the validity of the Glynn County ordinance (adopted November 6, 1928, amended August 6, 1929). This ordinance was designed especially to preserve the amenities of St. Simon's Island, a resort, and of a strip along the main highways.

This decision did not disturb the Fulton County Act which was grounded on a special constitutional amendment of 1926.

[7] Acts 1937, pp. 24 and 1135. They will fit into the Constitution as Par. 26, Sec. 7, Art. 3.

An earlier effort to obtain constitutional authorization for zoning in specified counties had failed in the general election of 1930 (Acts 1929, p. 148).

[8] Governor's No. 5, 1st Spec. Sess. 1937, approved December 6, 1937. Glynn is the county in which the coastal city of Brunswick is located.

[9] "Problems and Suggestions in the Drafting of Rural Zoning Enabling Legislation" (Resettlement Administration, Land Utilization Division, Washington, December, 1936, mimeo.).

[10] The Planning Board, created by Section 3 of the act, and composed of two ex-officio and three appointive members, is also the zoning commission. Specific authority is given to employ "the services of a competent engineer or expert in county planning and zoning" at a compensation agreed to by the Commissioners of Roads and Revenue.

Although the terms of the Glynn County Act embrace purely rural type zoning, of the sort associated with Wisconsin, as well as the urban or semi-urban type, its sponsors plan for the present to zone only along the coastal highway and in the essentially urban resort area of St. Simon's Island. This provides the setting for the second act of the Georgia series: one applying to Chatham, Bryan and Liberty Counties, which, like Glynn, are traversed by the coastal highway.[11] This statute is virtually identical with the above discussed Glynn County Act, with the following exceptions: (1) the area in which the powers granted may be exercised is limited to a strip along the highways, 200 feet from the center-line on each side; (2) provision is made for coordinating the zoning program of these counties specifically with that of Glynn County; and (3) no provisions are made for general planning activity or for subdivision control. The whole object of the act is to permit action necessary to preserve the attractions of the highway system, especially the coastal highway.

A third statute empowers the county governing authorities of DeKalb and Richmond Counties, respectively, in very general terms to

"pass zoning and planning laws whereby such county or counties may be zoned or districted for various uses and other or different uses provided (sic) therein, and regulating the use for which said zones or districts may be set apart and regulating the plans for development and improvements of real estate therein."[12]

While the authorization is thus broad enough to include all types of zoning, the presumption is that its primary purpose, for the time being at least, is to provide for regulation in urbanized or urbanizing situations. Each of the counties affected has a population of between 70,000 and 75,000;[13] one adjoins Fulton County, the location of Atlanta, and the other is the seat of the City of Augusta. For the rest, no use district may be established without the consent of 51% of the persons owning property within it; and provisions for zoning commission, board of appeals, and the other usual features of a zoning act are lacking.

The fourth statute of the series is one empowering the Commissioner of Cobb County to adopt ordinances creating zones "for various uses" and "prohibiting or regulating the use of property located in said zones or districts for purposes other than those prescribed."[14] The types of regulations which may be adopted are those generally associated with urban zoning: i.e., building regulations and regulations of property uses "for certain businesses, trades, professions, industries, etc." The drawing of all use district lines must be preceded by a survey and the preparation of a diagram or plat by the county surveyor. For the rest, this statute, like the DeKalb-Richmond County Act, lacks features normally included in a zoning law. Unlike the DeKalb-Richmond Act, however, no specific provision is made for enforcement.

Virginia

The regular 1938 session of the Virginia General Assembly[15] has conferred zoning powers on all counties having, now or subsequently, a population density not exceeding 500 per square mile and a planning commission created pursuant to the county planning act of 1936.[16] Inasmuch as a 1927 statute already enables counties with a population density of 501 or over per square mile to zone,[17] legislation now in force supplies zoning authority to all Virginia counties.

The new law empowers the governing bodies of the several counties to regulate, outside the corporate limits of municipalities, "the locations of those areas which may be used as places of residence or in which agriculture, forestry, trade, industry, or other specific uses may be conducted," as well as to prescribe the usual building and lot restrictions common to urban zoning. The county planning commission is vested with zoning commission functions; its suggestions must be obtained in connection with

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[11] Governor's No. 254, 1st Spec. Sess., approved January 26, 1938. The bill as introduced included also McIntosh and Camden Counties, which are the remaining two coastal counties of the State. These, however, were deleted before the bill passed.

[12] Governor's No. 133, 1st Spec. Sess., approved January 10, 1938.

[13] The statute does not specifically mention the names of any counties, but its provisions are operative only in counties of a population not less than 70,000 or more than 75,000.

[14] Governor's No. 108, 1st Spec. Sess., approved December 29, 1937. Cobb County adjoins Fulton County.

[15] H.B. 189, approved April 1, 1938.

[16] Acts of 1936, c. 427.

[17] Acts of 1927, c. 15, Extra Session. The counties affected by this law are Arlington, Chesterfield, Henrico, and Norfolk.

changes and amendments (both in the zone plan and in the zoning ordinance) as well as with the original ordinance itself. In carrying out its duties, the planning commission is authorized to cooperate with other planning and legislative bodies, including the State Planning Board.

The provision for boards of adjustment lacks the customary detail: the county governing body (normally the board of supervisors) is authorized in broad terms to create, at its discretion, such a board and prescribe its organization, procedure, and jurisdiction. Another unusual feature of the board of adjustment section is the provision that appeals from its decisions may be taken to the county governing body, which is given power to "approve or disapprove." It will be seen, in the discussion below, that this provision contains the germ of an idea which is more fully developed in the Michigan township zoning law.

Finally, this new Virginia act provides that the discontinuance of a non-conforming use entails the immediate loss of the right to non-conformance; that an administrative officer, with power to enter upon and inspect private property, may be appointed by the county to aid in enforcing any zoning ordinance which may be adopted; and that infractions of zoning regulations are punishable as misdemeanors, as well as subject to court restraining orders at the instance of the county authorities.

Florida

Two zoning acts applying in territory outside municipal limits were enacted in the recent session of the Florida Legislature. One of these, an unusual sort of enactment, is virtually a legislative zoning ordinance; it decrees that no property within certain enumerated and defined localities adjacent to the City of Tampa may be used except for private residential purposes.[18] The other enables the board of county commissioners of Dade County (location of Miami) to adopt and enforce zoning regulations affecting the uses of both "land and water."[19] Although, according to recent advices, local parties may possibly be looking forward to zoning in the distinctly rural areas of the county pursuant to a rural land-use classification, the act on its face seems to be limited to the type of zoning peculiar to urban or semi-urban situations. In the first section the provisions apply to "... buildings and other structures ... the percentage of lot that may be occupied, the size of yards ... the density of population, the use of land for junk yards and autombile trailer camps, and the location and use of buildings, structures and land for trade, industry or other specific use"; and in the next section, which treats specifically of the districting regulations envisaged, the terms are even more limited: to-wit, "the erection, construction, reconstruction, alteration, repair or use of buildings and structures."

The ordinary provisions are made for a zoning commission, for procedure to be observed in proposing and adopting an ordinance, and for remedies and penalties, although provisions relating to non-conformance are lacking. One unusual feature is the provision conferring upon the Governor of the State the duty of appointing the members of the Board of Adjustment. One section authorizes the County Board to designate the County Engineer, or any of its other employees, to serve as enforcement officer. Not exceeding $10,000 annually may be appropriated out of the general county fund to defray expenses in connection with the authorized program and its administration.

Michigan

As early as 1929 Michigan had a statute permitting zoning outside municipalities.[20] In its original form, this statute enabled any organized township to adopt and enforce zoning ordinances of the urban type; but in 1935 certain major changes were made in it. *Inter alia*, the powers outlined were broadened to include rural-type objectives, and the authority vested in townships was transferred to counties.[21] Beginning in 1935, therefore, counties alone could carry out rural zoning.

[18] S.B. 1066, approved June 11, 1937. The areas affected by this legislative fiat lie within "Golf View Place," "Golf View Park," "Morningside Subdivision," and "Southland Subdivision."

[19] Laws 1937, c. 17833. The act in its terms is operative in all counties with a population of 180,000 or over according to the last state census. Dade County alone qualifies.

[20] Public Acts of 1929, No. 79, as supplemented by Public Acts of 1933, No. 118.

[21] Public Acts of 1935, No. 44. For a discussion of this act see J. H. Marshall and V. W. Johnson, "Rural Zoning Progress in Michigan," *Land Policy Circular*, December, 1936, pp. 18–23.

In 1937 the Legislature altered this situation by restoring zoning powers to certain townships—those having a population of 5,000 or over and those adjacent to cities of a population of not less than 40,000.[22] While the powers granted are not in terms limited to zoning of the urban type—to the contrary, in fact—the heavily populated character of the townships in which the act is operative suggests that this sort of zoning is emphasized. This inference is strengthened by a reading of the statements of "purposes in view," contained in the opening three sections, as well as by the specific provisions regarding building regulations in Sections 7 and 9.

As outlined in Sections 1, 2, and 3, the character of the zoning permissible is comprehensive. Section 1 relates generally to regulating "the use of land for trade, residence, recreation, agriculture, forestry, soil conservation, water supply conservation" and to the regulation of "buildings or structures" and of "trades and industries." Section 2 varies the enumeration so as to include specifically, *inter alia*, the control of the use of "tents and automobile trailers for community dwelling purposes"; and the terminology of Section 3 relates to limiting the "maximum number of families which may be housed in dwellings hereafter erected or altered."[23] A composite statement of the purposes in view comprehends the avoiding or lessening of traffic and population congestion; the facilitation of adequate transportation, sewage disposal, water, educational and recreational facilities; the discouraging of "overcrowding and improper utilization of land"; the conservation of property values and natural resources; and the promotion of "public sanitation, health, safety and general welfare."

Each township in which the act is operative is required to set up a judicially appointed bi-partisan planning board of four members, charged with advisory duties of both a planning and a zoning nature.[24] Contrary to usual practice, the planning board is not required to hold hearings on its zoning recommendations. The only hearing required in this connection is that held by the township governing body (the township board) prior to the adoption of any proposed zoning ordinance.[25] No ordinance may become effective in any land-use district (zone) until after a favorable referendum of the electors therein.[26] Another unusual feature is the provision that the board of appeals be composed of the enacting authority, the township board.[27] Necessary expenses incurred in carrying out the act may be met by revenues from building permits and from a general property tax levied by the township for zoning purposes. Possible conflicts between the county zoning law and this act are resolved in favor of the latter.

Others

The California Planning Act of 1929[28] was amended in some detail, with the result, *inter alia*, of improving its utility for county rural zoning purposes.[29] In Indiana a joint resolution of the Legislature directs the state planning board, with technical assistance from the highway commission, to prepare a bill which would include provisions for strip zoning along the highways.[30]

Bills which Failed of Enactment

In New Hampshire, Senate Bill No. 55, granting to towns (townships) and cities the power to zone for agriculture, forestry, soil conservation, water conservation, and wildlife regulation purposes, among other things, passed the Senate but was killed by the lower chamber. In Minnesota each house of the Legislature had under consideration a bill which would have enabled counties to carry

[22] Public Acts of 1937, No. 302.

Other township zoning bills introduced in the same session, but which failed to pass, were: S.B. 81 and H.B. 510, applying only to townships with a population over 10,000; and H.B. 569, applying only to those contiguous to cities with a population of 100,000 or more.

[23] The reason for not consolidating the grants of power into a single section is not entirely clear. Force of habit seems to be the explanation.

[24] The members of this board are appointed by the probate judge or judges of the county in which the township is located.

[25] The act is silent as to requirements for making amendments.

[26] In comparison, the referendum provided in the county act is on the question whether the county authorities shall be allowed to proceed, rather than on a specific ordinance.

[27] This is similar to the provision of the 1929 township act. Under the county act, the board of appeals consists of the members of the county planning board acting with an equal number of persons designated by the state planning commission.

[28] Stats. 1929, p. 1805.

[29] Stats. 1937, c. 665.

[30] Laws 1937, c. 321.

out a rural zoning program; but, though these bills were respectively reported out of committee, they never came to a vote.[31] In Mississippi, identical bills authorizing rural-type zoning in all counties were introduced in both houses (regular 1938 session), but failed to receive favorable action.[32]

Essentially urban-type bills applying to counties with a population density of 250 per square mile or over were introduced into both houses of the Ohio Legislature.[33] One of them passed the Senate but was not acted on by the House; the other was reported out of the House Committee but did not come to a vote. A proposed Colorado county enabling act, likewise essentially of the urban type, died in committee.[34] An abortive bill in the Kansas Legislature would have prohibited the erection of any structure within 200 feet of the center line of a state highway;[35] and a similarly unsuccessful Connecticut bill would have empowered the state highway commission to remove any sign-board or other structure located within 15 feet of a highway right-of-way, if a traffic hazard.[36]

Conclusion

During 1937 and the early part of 1938 comprehensive rural zoning enabling acts applying to all or nearly all counties were adopted in Pennsylvania and Virginia, and applying to a limited number of counties in Tennessee and Georgia. In addition, second-class Pennsylvania townships and certain Michigan suburban townships were enabled to zone, as were a very small number of suburban counties in Georgia and Florida; and, in California, existing county zoning procedures were improved. In several other states, unsuccessful efforts were made to secure passage of enabling legislation.

These acts all contain authorization for urban- or suburban-type zoning, many of them being essentially limited to this type, either in terms or in their evident purpose. The acts applying to Pennsylvania, Virginia and Tennessee counties, to Glynn County (Georgia), and to Michigan townships, however, expressly include rural-type objectives, and may clearly be used for purely rural zoning. But the incidents of the Michigan township act and recent information concerning the Tennessee[37] and Glynn County acts indicate that these, at least, will be applied for the present primarily to urbanized or suburbanized conditions.

As to their procedures, although most of these recent acts follow the broad outlines of the usual zoning statute, there are a number of variations in detail. The Tennessee legislation, for example, is unique in that it confers on a regional planning commission, constituted under previous legislation,[38] the functions normally given a county zoning commission, and thus emphasizes a regional approach to the problem; and the same approach is encouraged, though not required, in the legislation applying to the coastal counties of Georgia. In the Pennsylvania County act, impetus is specifically given to state-wide coordination, through the requirement for prior submission of any proposed ordinance to the State Planning Board for its advice and suggestions. In a number of the acts zoning is clearly recognized to be an integral part of general planning activity in that zoning commission functions are to be exercised by bodies having general planning

[31] H.B. 1019 and S.B. 1198. The grant of power in each was phrased in the following terms: "The Board of county commissioners of any county may by ordinance regulate, restrict, and determine the areas within which agriculture, forestry and recreation may be conducted and may establish districts . . . and may also establish setback building lines . . . "

[32] S.B. 415, H.B. 844. One interesting feature of the bills was the provision that "classification of rural lands for the purpose of land use adjustment and zoning shall be based, among other things, upon adequate investigation and study of soil, drainage, and erosion factors, tax delinquency, existing uses and economic status attained, location, size and condition of farms, extent of farm abandonment, amount of idle land, and quality of buildings; potential recreational values; economic ill effects of improper timber cutting; scattering of population; fire hazards attendant upon remote human habitation, and trends in land-use; school locations, school costs per capita; tax burdens in the form of road maintenance and other necessary costs imposed upon the community by uncontrolled and unregulated settlement on or occupation of submarginal rural areas; the location, desirability, and necessity for continuing or improving existing roads or constructing others that may be needed, and the provision of transportation, water, sewage, lighting, and other public requirements." In addition to the usual features of a rural zoning enabling act, provision was made for an ex officio state rural zoning committee with advisory duties.

[33] S.B. 23; H.B. 98.

[34] H.B. 644.

[35] S.B. 470.

[36] H.B. 1278.

[37] See J. H. Marshall, *loc. cit.*, p. 420.

[38] Pub. Acts 1935, c. 43.

duties, as in the acts of Virginia, Michigan, Tennessee, and Glynn County (Georgia). At the other extreme is the legislation applying to DeKalb and Richmond Counties (Georgia) which makes no provision at all for research and advisory functions to be carried out by a body separate from the local enacting authority. Although the members of such advisory commissions are commonly designated by the local governing bodies, the Michigan act curiously vests the appointing power in the judiciary, and in Tennessee the appointing function is exercised by the State Planning Commission.

The differences in the treatment of the board of adjustment function are also striking. These range from complete silence in the Cobb, DeKalb and Richmond County (Georgia) acts to mandatory boards provided for in considerable detail in the Tennessee, Florida, Pennsylvania county, and Georgia coastal county acts. In the Michigan and Virginia acts, although such boards are authorized, the details regarding their specific functions are left to be formulated, within general limits, by the local governing authorities. In the Florida act, the members of the board are to be appointed by the governor; in the Michigan act, the governing body is itself the board of adjustment; and in the Virginia act, the governing body has final control over decisions of the board.

Other differences of particular interest here are those regarding referenda, nonconforming users, and enforcing officers. Most of the acts do not provide for referenda. However, the Michigan act provides that no ordinance may become effective in any restricted district until after a favorable vote by the electors therein; the DeKalb-Richmond County (Georgia) act similarly requires the consent of a majority of the landowners in a restricted district; and the Pennsylvania township act provides that zoning powers may not be exercised if persons owning a majority of the total property valuation within the township file written protest. The most notable observation to be made concerning non-conforming use (a subject on which some of the acts are silent) regards the Pennsylvania county act and the Georgia coastal county acts, which give authority for eliminating established uses.

In sum, during the period covered, a variegated body of legislation has thus made moderate additions to the rural territory subject to zoning. Though the more material advances were made in the East, in an area bounded on the north by Pennsylvania, on the south by Georgia, and on the west by the Tennessee mountains, the evidence is clear that the rural zoning idea is becoming more widely and thoroughly diffused throughout the country.[39] Moreover, while regulation in urbanized or semi-urbanized situations probably continues to receive major emphasis in extra-municipal zoning, there has been substantial and patent progress in the idea of distinctly rural-type zoning—of the sort associated with Wisconsin.

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[39] Previously enacted rural zoning law includes the general county enabling legislation of Wisconsin, Michigan, Indiana, California and Washington; the essentially urban-type county acts of Illinois, Michigan (eleven counties), Virginia (four counties) and Tennessee (one county); and the fundamentally urban-type town(ship) enabling acts of Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Vermont.

Public Utilities Department

E. W. Morehouse, *Editor*

From Veto to Validation of the Wisconsin Development Authority

FOR a supreme court to reverse a unanimous decision within six months is nearly unprecedented. Yet that is precisely what has happened to the Wisconson Development Authority Act.

In January, 1938 the State Supreme Court unanimously invalidated the Wisconsin Development Authority Act;[1] in June, 1938, after re-argument and reconsideration, the same court reversed its earlier decision and substantially upheld the appropriation act under review. The later decision was divided, one justice concurring in a separate opinion and two justices dissenting.

Underneath this reversal lay a complex struggle of opposing forces. In the forefront was the obvious, much controverted issue of whether or not encouragement of public or cooperative ownership of public utilities was a legitimate state purpose, warranting an appropriation of state funds. The political ramifications of this issue are evident. In the background was the question of the validity of state aids to a number of private organizations. The sweeping character of the first ruling had placed these in jeopardy.

In the earlier opinion the court viewed the act as conferring sovereign power upon a private corporation, which, under previous decisions, could not hold public office or perform the duties or functions thereof. Hence, the court reasoned, there was an unconstitutional delegation of powers. This position is now abandoned. The act is now regarded as merely an appropriation measure, delegating no govermental powers. The reversal, according to the majority opinion, was accomplished by the simple expedient of finding that the Authority was incorporated prior to passage of the act and that the corporate charter provided for doing the very things for which the appropriation was made. In the words of the court:

> "The foregoing comparison of statutory provisions with corporate power indicates that at the time of the enactment the corporation was empowered by its articles to do everything that it could do after the enactment of the statute. This being true, we cannot escape the conclusion that the statute conferred no power upon it."

Furthermore, limitations on the use of funds, under the court's interpretation, so diminish the discretion of the Authority that what remains is not regarded as "a power sovereign in character."

The court circumscribed the use of funds by the Authority to purposes which the court felt were proper by the double standard of public purpose and state purpose. By this double test state funds cannot be used to urge or assist a particular group or municipality to construct or acquire a particular plant. That is a matter of local, not state, concern, however much it may be in the interest of the public of that locality. This double standard has the effect of restricting the Authority's activities, so far as they are financed by state appropriations, to state-wide education, research, promotion, or encouragement of public or cooperative ownership.[2]

Applying the foregoing principles to the facts in the cases bringing the act under review, the court held that two of the three

[1] E. W. Morehouse, "A Judicial Veto in Wisconsin," 14 *Journal of Land & Public Utility Economics* 98 (February, 1938).

[2] The court also considered and denied the following added objections to the act: (1) that the act granted a special privilege to a private corporation, in violation of Sec. 31, Art. IV of the Wisconsin Constituton, because the Authority directly or through the Governor, could have access to or command the information or services of the Public Service Commission; (2) that the act delegates judicial powers to the Secretary of State because that official is required to audit the Authority's disbursements of state funds; (3) that the act violates Sec. 3, Art. VIII of the Wisconsin Constitution by lending the credit of the State to the Authority; (4) that the act violates Sec. 26, Art. IV of the Wisconsin Constitution prohibiting any change in compensation of a public officer during his term of office, because two members of the Authority were members of the legislature which passed the act (no provision is made in the act or by the Authority to pay members or officers of the Authority, which is a non-profit corporation); (5) that the whole appropriation is void because two of the declared purposes are declared invalid.

bills should be audited and paid. The one declared invalid was for services performed in promoting a cooperative electric association in Crawford county. This was considered a local, not a state, problem. Of the two ordered paid, one was for services in planning an investigation of the power resources and facilities of the State, and the other was for multigraphing a letter to be sent to all municipalities of the State offering the Authority's assistance in municipal acquisition or operation of utility plants. The letter was regarded as objectionable in offering promotional services to the particular city addressed, but this feature was regarded as incidental to the main purpose of bringing the Authority's proper functions to the attention of municipalities as a whole.[3]

Mr. Justice Fairchild, in dissenting, adhered to the original position of the court. He felt that the Authority still had power to act as a public official through its power to command the information and services of the Public Service Commission. He also regarded the Authority as a "militant agency, aggressively devoted to the building up of organizations to compete with privately owned utilities. . . . " Such an agency could not be a non-partisan educational organization, presenting both sides of a question. Moreover, he believed it would be impracticable to encourage the formation of power districts in general without promoting particular power districts. In brief, the double standard set up by the majority would not work. The gist of his view is in the final two sentences of his opinion:

"If the people desire to use public money for the discouragement of profit-making enterprises, a constitutional amendment would afford them the opportunity to pass valid legislation. The people are the ultimate source of power, and the issue should be framed and settled in the manner contemplated by the constitution."

Mr. Justice Fowler dissented primarily because he construed the act as class legislation repugnant to an inherent right of equal opportunity, as expressed in Sec. 1, Art. I of the State Constitution. It is not a proper function of government, or proper use of public funds, he said, to preach the advantages of public or cooperative ownership of utilities over private ownership. "It is no function of government under our constitution so to preach against privately owned and operated utilities. It is mere propaganda as distinguished from dissemination of information to the public." He adds: " . . . it is no function of government under our state and federal constitutions to advocate the principles of any political party, and public funds cannot be expended for that purpose." In his opinion the severability clause is of no avail when the dominant purpose of the whole act is unconstitutional.

With the WDA sustained, it now turns to the task of operation. On this plane its efficacy must be tested in the future. How effectively it can operate within the limits laid down by the court will be determined largely by the ingenuity, resourcefulness, and general quality of the personnel selected for the task.

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[3] Mr. Justice Fritz, separately concurring, objected to the majority's reliance on the existence of corporate powers prior to passage of the act. He felt that the restricted scope of the Authority's activities did not constitute the exercise of governmental power.

The New Federal Spending and Public Ownership of Utilities

WHAT effect, if any, will the new spending program of the Federal Government have upon the stimulation and advancement of public ownership in utilities, especially electricity? To indicate the answer requires brief survey of what the government had undertaken previously, as well as the new provisions of the Work Relief and Public Works Appropriation Act, approved June 21, 1938, applicable to the Public Works Administration, the Works Progress Administration, and the Rural Electrification Administration.

The federal agency which has had most direct influence on the extension of public ownership of electric power, especially by municipalities, is the PWA. Up to June 1, 1938 it had made a total of 274 allotments for projects involving the construction, repair, extension, or improvement of electric generating supply or distribution systems. To finance these projects, it had made outright grants of $64,580,277 and loans of $79,744,206, or a total allotment of $144,324,483. In addition, the applicants were to provide $73,895,871, bringing the

total estimated construction cost up to \$218,220,354. About 1/3 of the number of projects and about 85% of the total cost involved construction of new publicly owned electric systems.

Up to the beginning of this year, a considerable number of these projects, 61 in 23 states, had been held up through injunctions issued by federal and state courts. The restraints involved both the right of the municipalities to undertake the developments as formulated and the right of the PWA to make the grants and loans. While these issues were not all determined, they were brought before the Supreme Court of the United States, which on January 3, 1938 held that the municipalities had the right to establish the utilities and that, therefore, the companies did not have legal status to bring the suits for injunction.[1] While PWA's own direct right was thus not determined, it was left nevertheless in position to proceed with the grants and loans, and the municipalities were freed from the previous legal restraints. The 61 projects involved an estimated total construction cost of \$146,917,808, for which PWA had allotted \$61,225,544 as loans and \$38,412,408 as grants, or an aggregate of \$99,637,952, compared with \$144,324,483 for the total 274 projects approved as of June 1, 1938.

Under the new Act, further appropriations have been made available for municipal and other public power developments. Under Title II, the PWA receives a total appropriation of \$965,000,000, to remain available until June 30, 1940, to be expended for (1) the making of allotments to finance federal projects, or (2) the making of loans or grants, or both, to states, territories, possessions, political subdivisions, or other public bodies (called public agencies), or (3) the construction and leasing of projects, with or without the privilege of purchase, to any such public agency; provided, that no funds thus appropriated shall be available for acquisition of lands to enlarge Indian reservations.

No funds shall be allotted for any project which cannot be commenced prior to March 31, 1939 or which cannot be substantially completed prior to September 30, 1940, but this limitation does not apply to any project enjoined in any federal or state court. Of the \$965,000,000, no more than \$750,000,000 may be used for grants or for defraying the estimated non-recoverable proportion of the cost of projects constructed for lease to public agencies. No such grant may exceed 45% of the cost of any non-federal project. To what extent the available funds will be allotted to electric power properties, especially for municipally owned systems, is problematical. It will depend, first, upon actual municipal or other public applications, and second, upon the decision of the Administrator.

In making allotments, the Administrator has wide discretion. While no restrictions have been imposed upon him, there has been at least a quasi-public announcement that grants and loans will not be made for construction and development of competitive electric systems unless real effort has been made to purchase the existing privately owned facilities at a reasonable price. The Administrator, however, will apparently be the judge as to the adequacy of the effort and the reasonableness of the price offered. Whatever projects may be approved and new funds allotted, because of the January 3 decision by the Supreme Court, they will probably not be faced with extensive legal opposition on the part of the companies, and, on the basis of unofficial White House pronouncements, probably in most instances there will be reasonable efforts to acquire the existing facilities and to avoid undesirable competitive conditions.

The Act appropriates also \$1,425,000,000 to the Works Progress Administration. Of this amount, \$655,500,000 will be available jointly for federal and non-federal activities, including public buildings, parks, and other recreational facilities, public utilities, electric transmission and distribution lines, or systems to serve persons in rural areas, including projects sponsored by and for the benefit of non-profit and cooperative associations, together with other public activities designed to furnish prompt work relief. The funds are available for distribution up to February 28, 1939.

Again, how large a proportion of the total WPA appropriation will be devoted to public ownership extension is problematical, depending upon the applications and upon decisions by the Administrator. Since the object is to furnish prompt work relief within a short period, the activities will probably

[1] *Alabama Power Co. v. Harold L. Ickes et al.*, 302 U.S.; 82 L. ed.__; 58 S. Ct. 300; 21 PUR 289 (N.S.) 1938.

be limited largely to maintenance and improvements which can be rapidly undertaken and carried out, and not to establishment of new municipally owned systems to replace or to compete with present privately owned properties.

Besides PWA and WPA, the Rural Electrification Administration comes within the public ownership domain. It is primarily concerned with making loans for electric developments for the benefit of rural areas. Its loans to municipal systems depend upon whether they will go into rural electrification. They may be applied both to generating plants and to transmission- and distribution-line construction, if these facilities are actually for rural service. Many such loans have been made, but the great majority have been extended to cooperatives. When wholesale electric energy is purchased from municipal systems, it is based as a general policy on an average rate of 1.25¢ per kilowatt hour or less. There are wide variations in the contracts.

The REA had a regular appropriation of $40,000,000 and was allowed by the new Act an additional $100,000,000 for rural electrification, presumably not a part of the WPA appropriation. While the additional appropriation is, of course, needed for desirable rural electric expansion, Congress did not provide proportionately for administrative expenses, and thus places REA under handicaps in actually carrying out the enlarged program. The effect upon the extension of public ownership is not likely to be great. The municipal systems are often restricted to their own municipal borders, and even where they are able to serve adjacent rural territories, they are not always in position to do so. Nevertheless, active municipal efforts are made frequently to provide rural service, and REA funds will be available for that purpose. Furthermore, while loans are primarily extended to cooperatives, these organizations are quasi-public in character and doubtless in many instances furnish the first step to outright public organization and management.

While doubtless the new appropriations and the clearer powers of the federal agencies will stimulate advance in public ownership of electric power, the advance is not likely to be particularly great. The bulk of the electric industry, over 90%, is organized and managed in private form. This percentage will probably not be reduced materially by the public ownership activity stimulated by the federal appropriations and activities.

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The Morgan Case:

The Supreme Court on Procedure in Administrative Adjudication

DESPITE the fact that the system of administrative adjudication, even in the United States, has a considerable history,[1] the legal profession, generally, still lacks the knowledge necessary to a true understanding of the workings of administrative tribunals. Especially is this true in the field of administrative procedure. The publication, in the *Federal Register*, of the rules of procedure of the various agencies, which in the past were, in a number of cases, practically unavailable, should have a marked effect on dispelling the general ignorance of the subject. In addition, the Supreme Court of the United States has recently handed down several opinions on procedural questions. One of the most recent seems important enough to warrant a full discussion of it.

In *Morgan* v. *United States*, 303 U. S. —, 82 L. Ed. 757, 58 S. Ct. 773 decided April 25, 1938, the Court, with Mr. Justice Black dissenting, for the second time[2] reversed a decree of the District Court of the United States for the Western District of Missouri holding valid an order of the Secretary of Agriculture fixing maximum rates to be charged by market agencies at the Kansas City Stockyards. The plaintiffs had attacked the order on the grounds that they had not been accorded the hearing which the statute

[1] For example, the Interstate Commerce Commission was established by the Act of February 4, 1887, 49 U.S.C.A. §11; the Federal Trade Commission was established by the Act of September 26, 1914, 15 U.S.C.A. §41.

[2] The opinion on the first appeal may be found at 298 U. S. 468, 80 L. Ed. 1288, 56 S. Ct. 906, same title (1936).

made a prerequisite of a valid order,[3] and that the order was arbitrary and unsupported by the evidence.

The Court's decision concerns itself entirely with the first of these objections to the order's validity, so that a detailed account of the administrative procedure seems necessary.

The original administrative proceeding was begun on April 7, 1930, when the Secretary issued an order of inquiry and notice of hearing as to the reasonableness of the rates of plaintiffs for stockyard services at Kansas City. Taking of evidence before an examiner was begun late in that year and continued for about two months. Both the Government and plaintiffs were represented by counsel and a large record was made. Thereafter an oral argument was had before the Acting Secretary and plaintiffs submitted a brief. In May, 1932 the Secretary issued an order prescribing maximum rates but in view of changed economic conditions that order was vacated by the Secretary and a rehearing was granted. This was begun in October, 1932 and concluded a month later. In March, 1933 oral argument was had before Rexford G. Tugwell as Acting Secretary, and the plaintiffs presented the brief which had been filed after the first oral argument, and a supplemental brief dealing with the evidence introduced upon rehearing. No brief at any time was supplied by the Government. Plaintiffs requested that the examiner prepare a tentative report to which they might be allowed to file exceptions, but this request was refused.

Thereafter it appears that findings were prepared by the Bureau of Animal Industry of the Department whose representatives had appeared in the proceeding on behalf of the Government. These findings, with a few changes, were signed by the Secretary when his order was entered on June 14, 1933. The application of the plaintiffs for a rehearing was denied in July, 1933, and these suits followed. The original bills of complaint alleged that the order of the Secretary was null and void because their request that the examiner prepare a tentative report which should be the subject of exceptions and oral argument had been denied, and that the Secretary had, without warrant of law, delegated to acting secretaries the determination of issues as to the reasonableness of the rates involved, although at the time of the oral argument the Secretary was in no wise disabled but was at his office in the department; and that at the time the Secretary signed the order in question he had not personally heard or read any of the evidence presented at any hearing and had not heard or considered the oral argument with respect thereto, or the briefs submitted therein, but had derived his only information on the matter in consultation with employees of the Department outside of the presence of the plaintiffs, or any of their representatives.

On motion of the Government the District Court struck out all those allegations in the bill, and on the first appeal the Supreme Court held that it was error for the District Court to have stricken these allegations from the bill for the reason that

"A proceeding of this sort requiring the taking and weighing of evidence, determinations of fact based upon the consideration of the evidence, and the making of an order supported by such findings, has a quality resembling that of a judicial proceeding. Hence it is frequently described as a proceeding of a quasi judicial character. The requirement of a 'full hearing' has obvious reference to the tradition of judicial proceedings in which evidence is received and weighed by the trier of the facts. The 'hearing' is designed to afford the safeguard that the one who decides shall be bound in good conscience to consider the evidence, to be guided by that alone, and to reach his conclusion uninfluenced by extraneous considerations which in other fields might have play in determining purely executive action. The 'hearing' is the hearing of evidence and argument. If the one who determines the facts which underlie the order had not considered evidence or argument, it is manifest that the hearing has not been given."[4]

When the matter was remanded to the Dis-

[3] Section 310 of the Packers and Stockyards Act (42 Stat. at L. 159, 166, chap. 64; 7 U.S.C.A. §211) provides:

"Sec. 310. Whenever after full hearing upon a complaint made as provided in §309, or after full hearing under an order for investigation and hearing made by the Secretary on his own intiative, either in extension of any pending complaint or without any complaint whatever, the Secretary is of the opinion that any rate, charge, regulation, or practice of a stockyard owner or market agency, for or in connection with the furnishing of stockyard services, is or will be unjust, unreasonable, or discriminatory, the Secretary—

"(a) May determine and prescribe what will be the just and reasonable rate or charge, or rates or charges, to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged, and what regulation or practice is or will be just, reasonable, and non-discriminatory to be thereafter followed. . . . "

[4] 298 U. S. 486, 481 (1936).

trict Court, the plaintiffs submitted over 100 interrogatories to the Secretary asking among other things how much time he had devoted to the testimony of each witness, to each exhibit, what weight he had accorded to such testimony, what pages of the brief he had read, what theories of rate-making he had considered and rejected, etc.

Thereafter the District Court rendered an opinion holding that the hearing before the Secretary was adequate, that on the merits the order entered was lawful (*Morgan* v. *United States*, 18 F. Supp. 1017 (1937)).

A careful consideration of the language of the Supreme Court's opinion on the second appeal discloses that its conclusion that the hearing afforded the plaintiffs was not the "full hearing" required by the regulatory statute[5] rests wholly on the ground that the plaintiffs were not advised as to the contentions of the Government (here represented by members of the Bureau of Animal Industry) until the final order was entered by the Secretary. The Court speaking through the Chief Justice said:[6]

"The right to a hearing embraces not only the right to present evidence but also a reasonable opportunity to know the claims of the opposing party and to meet them. The right to submit argument implies that opportunity; otherwise the right may be but a barren one. Those who are brought into contest with the Government in a quasi-judicial proceeding aimed at the control of their activities are entitled to be fairly advised of what the Government proposes and to be heard upon its proposal before it issues its final command.

"No such reasonable opportunity was accorded appellants. The administrative proceeding was initiated by a notice of inquiry into the reasonableness of appellants' rates. No specific complaint was formulated and, in a proceeding thus begun by the Secretary on his own initiative, none was required. Thus, in the absence of any definite complaint, and in a sweeping investigation, thousands of pages of testimony were taken by the examiner and numerous complicated exhibits were introduced bearing upon all phases of the broad subject of the conduct of the market agencies. In the absence of any report by the examiner or any findings proposed by the Government, and thus without any concrete statement of the Government's claims, the parties approached the oral argument.

"Nor did the oral argument reveal these claims in any appropriate manner. The discussion by counsel for the Government was 'very general,' as he said, in order not to take up 'too much time.' It dealt with generalities both as to principles and procedure. Counsel for appellants then discussed the evidence from his standpoint. The Government's counsel closed briefly with a few additional and general observations. The oral argument was of the sort which might serve as a preface to a discussion of definite points in a brief, but the Government did not submit a brief. And the appellants had no further information of the Government's concrete claims until they were served with the Secretary's order."

In the first appeal the plaintiffs had pressed the point that the failure of the examiner to file an intermediate report invalidated the hearing and the Court had met this point squarely, saying:[7]

"Again, while it would have been good practice to have the examiner prepare a report and submit it to the Secretary and the parties, and to permit exceptions and arguments addressed to the points thus presented, —a practice found to be of great value in proceedings before the Interstate Commerce Commission—we cannot say that that particular type of procedure was essential to the validity of the hearing. The statute does not require it and what the statute does require relates to substance and not form."

Immediately upon the filing of the opinion in the second appeal counsel for the Government filed a petition for rehearing, charging that there was an inconsistency in the two opinions in that the first had held that an examiner's report was not indispensable while the second had held that the absence of such a report vitiated the proceedings. In a per curiam opinion,[8] with Mr. Justice Black again dissenting, the Court denied that it had overruled the prior holding and quoted from its opinion in the second appeal where it said:[9]

"The Government adverts to an observation in our former opinion that while it was good practice—which we approved—to have the examiner, receiving the evidence in such a case, prepare a report as a basis for exceptions and argument, we could not say that that particular type of procedure was essential to the validity of the proceeding. That is true, for, as we said, what the statute requires 'relates to substance and not form.' Conceivably, the Secretary, in a case the narrow limits of which made such a procedure practicable, might himself hear the evidence and the contentions of both parties and make his findings upon the spot. Again, the evidence being in, the Secretary might receive the proposed findings of both parties, each being notified of the proposals of the other, hear argument thereon and make his own findings. (__U. S.__, ante, 757, 58 S. Ct. 773.)

[5] See footnote 3 *supra*.

[6] 82 L. Ed. 757, 760.

[7] 298 U. S. 468, 478.

[8] 303 U. S. __; 82 L. Ed. 1030; 58 S. Ct. __.

[9] 303 U. S. __; 82 L. Ed. 1030, 1032; 58 S. Ct. __.

"And, then, pointing out the distinction and the serious defect in the procedure in the instant case, we added:

"But what would not be essential to the adequacy of the hearing if the Secretary himself makes the findings is not a criterion for a case in which the Secretary accepts and makes as his own the findings which have been prepared by the active prosecutors for the Government, after an ex parte discussion with them and without according any reasonable opportunity to the respondents in the proceeding to know the claims thus presented and to contest them. That is more than an irregularity in practice; it is a vital defect."

The Court also cited *National Labor Relations Board* v. *Mackay Radio and Telegraph Co.*, 303 U. S. __, 82 L. Ed. 861, 58 S. Ct. __, as consistent with this distinction. In that case the employer had contended that it had been denied a hearing by the Board in that the original complaint charged the employer with discriminating by *discharging* five men and, after the evidence was in, a new complaint was presented charging that the employer had *refused to re-employ* the five men, and the order had found the employer guilty of unfair labor practices in *discharging* the five men, and for the further reason that the Board had denied the employer's motion to require the preparation and filing of intermediate report by the trial examiner. The Court disposed of these objections summarily. As to the first they said:[10]

"A review of the record shows that at no time during the hearings was there any misunderstanding as to what was the basis of the Board's complaint. The entire evidence, pro and con, was directed to the question whether, when the strike failed and the men desired to come back and were told that the strike would be forgotten and that they might come back in a body save for eleven men who were singled out for different treatment, six of whom, however, were treated like everyone else, the respondent did in fact discriminate against the remaining five because of union activity. While the respondent was entitled to know the basis of the complaint against it, and to explain its conduct, in an effort to meet that complaint, we find from the record that it understood the issue and was afforded full opportunity to justify the action of its officers as innocent rather than discriminatory."

In ruling that the failure to require an examiner's report did not amount to a denial of a full and adequate hearing, the Court used the following language:[11]

"What we have said sufficiently indicates that the issues and contentions of the parties were clearly defined and as no other detriment or disadvantage is claimed to have ensued from the Board's procedure the matter is not one calling for a reversal of the order. The Fifth Amendment guarantees no particular form of procedure; it protects substantial rights."

The precise effect of these opinions on administrative procedure can be determined only by a careful examination of present practices in the various agencies. In the first Morgan opinion the Court recognized the fact that administrative officers and boards can handle the tremendous amount of detail with which they are confronted only by use of trained and competent assistants:[12]

"This necessary rule does not preclude practicable administrative procedure in obtaining the aid of assistants in the department. Assistants may prosecute inquiries. Evidence may be taken by an examiner. Evidence thus taken may be sifted and analyzed by competent subordinates. Argument may be oral or written. The requirements are not technical. But there must be a hearing in a substantial sense."

To those agencies where the officer or board itself hears the testimony and prepares the necessary findings and order, the Morgan case will have little, if any, significance. Moreover, in cases before the various agencies where the contest is between private individuals, as in the Mackay case, and not between representatives of the Government and private persons, as in the Morgan case, it is submitted that the administrative board or officer need have little concern with the procedural requirement of the latter named case.[13]

Indeed it is interesting to note that in the Morgan decisions the Court has rendered what really amounts to an advisory opinion in that, after laying down the requirement that in one of these proceedings the respondent must be advised by the Government of its contentions, the Court points out that an examiner's report, to which the parties may file and argue exceptions, will satisfy the requirement. This, of course, is not to say that other means of reaching the same result may not be used.

Of interest and importance in considering the Morgan case is a recent judicial interpretation of it by the Circuit Court of Appeals for the Ninth Circuit in *National Labor Relations Board* v. *Biles Coleman Lumber Co.*, No. 8764, June 23, 1938. In that case the

[10] 82 L. Ed. 861, 869.

[11] 82 L. Ed. 861, 870.

[12] 298 U. S. 468, 481.

[13] See quotation cited at footnote 9 *supra*.

respondent charged that it had been denied due process in that the members of the Board had not read the testimony taken before the trial examiner, that the findings of fact, conclusions of law, and the order had been prepared by employees of the Board, and that such findings, conclusions, and order had not been submitted to the Company before the order finding it guilty of unfair labor practices was entered.

After quoting from the opinion in the Morgan case on the first appeal[14] the Circuit Court said:

"It is obvious that such an administrative body, with scores of cases for its decision, many involving complicated questions of fact and often intricate questions of law, properly will rely upon its employees for assistance in their preparation. The administrative duties imposed upon the Board by Congress could not proceed otherwise."

On the question of necessity of submission of findings and conclusions to respondents the court said:

"The lumber company may not complain if, after the pleadings have properly advised it on the issues of fact and law and the Board's attorney has fully argued the points of fact and law upon which the Board contends the decision should be based, it is not offered proposed findings and conclusions of the Board, for the company's comment or suggestion.

"No such right exists at the common law where the parties have no access to the jury's special findings. *Campbell v. Boyreau*, 62 U. S. 223, 226. It is only by statute or rule, or in its discretion, that now in law cases without jury a court causes the submission of proposed findings to the losing party. Due process in the trial of facts in such a case as this is afforded to the parties if the process substantially gives to the losing party no less advantage than at the common law. *National Labor Relations Board v. Mackay Radio & Tel. Co.*, 303 U. S. __, 82 L. Ed. 861.

"We take it that what is said in *Morgan v. United States*, concerning the failure of the Secretary of Agriculture to submit such proposed findings to the party subject to his order, has to do with no more than their necessity to advise such a party of the specific contentions of law and fact relied upon for the Secretary's order, where, as in that case, there was no complaint, brief or argument on behalf of the Secretary which informed the ordered party of the contentions on which the order sought to be made by him was to be based. Here there was no absence of such advice and hence no reason to submit the findings."

Despite the fact that in the Morgan case the Court was concerned entirely with a construction of the term "full hearing" as it is used in the Packers and Stockyards Act, the Court is undoubtedly of the opinion that the "due process" provision of the Fifth and Fourteenth Amendments to the Constitution of the United States imposes the same requirements on administrative agencies. This seems to be borne out by Chief Justice Hughes' use of the phrase "fundamental requirements of fairness which are of the essence of due process."[15]

Critics of various administrative agencies have decried the fairly common practice of permitting members of the staffs of administrative agencies to testify in hearings either before the board or commission or a duly appointed examiner, and allowing counsel for the agency to cross-examine witnesses produced by respondents and generally to act as "opposing counsel," and then allowing the board to consult with these members of its staff in arriving at its conclusions. These critics will undoubtedly seize on the following language from the Morgan case as authority for their position:[16]

"Congress, in requiring a 'full hearing,' had regard to judicial standards,—not in any technical sense but with respect to those fundamental requirements of fairness which are the essence of due process in a proceeding of a judicial nature. If in an equity cause, a special master or the trial judge permitted the plaintiff's attorney to formulate the findings upon the evidence, conferred *ex parte* with the plaintiff's attorney regarding them, and then adopted his proposals without affording an opportunity to his opponent to know their contents and present objections, there would be no hesitation in setting aside the report or decree as having been made without a fair hearing. The requirements of fairness are not exhausted in the taking or consideration of evidence but extend to the concluding parts of the procedure as well as to the beginning and intermediate steps."

However, it seems clear from a consideration of the opinion in its entirety that the Court has not held that such procedure amounts to a denial of a "full hearing." The only requirement is that, if such procedure be followed, the respondent be fully advised of the Government's contentions prior to the entry of the final order.

The opinion in the first Morgan appeal[17] gave rise to considerable speculation as to the amount of consideration of evidence and argument the Court would require of ad-

[14] See footnote 12.

[15] 82 L. Ed. 757, 761. In the Mackay case the employer had specifically charged a contravention of the Fifth Amendment.

[16] 82 L. Ed. 757, 761.

[17] 298 U.S. 468, 481; quoted, *supra*, see footnote 4.

ministrative officers. The importance of this question becomes immediately apparent when it is noted that the administrative officer whose order was being reviewed, the Secretary of Agriculture, administers 42 regulatory statutes, a number of non-regulatory acts, such as the Soil Conservation and Domestic Allotment Act, and is a member of the President's Cabinet. Unless a large portion of the detail work involved can be delegated to competent subordinates it would be impossible for the Secretary to carry out his statutory duties. On this question, after quoting the Secretary's own testimony that the order in question represented his own "independent reactions to the findings of the men in the Bureau of Animal Industry," the Court said:[18]

"In the light of this testimony there is no occasion to discuss the extent to which the Secretary examined the evidence, and we agree with the Government's contention that it was not the function of the court to probe the mental processes of the Secretary in reaching his conclusions if he gave the hearing which the law required. The Secretary read the summary presented by appellants' briefs and he conferred with his subordinates who had sifted and analyzed the evidence. We assume that the Secretary sufficiently understood its purport."

While the Morgan case will require the various administrative agencies to examine their procedure to determine whether it meets the requirement imposed by the Court—namely, that respondents in proceedings initiated by the agency itself be fully advised of the board's contentions prior to final order—the opinion is bound to be of material aid in assisting the administrative tribunals in prescribing future procedure to meet that requirement, and is of tremendous interest in its recognition of the necessity for competent assistants and staff members in order that the functions of the various administrative officers may be properly exercised. The Morgan case undoubtedly imposes a technical procedural requirement of the type which quasi-judicial administrative agencies have sought to avoid on the ground that the detailed factual matters with which they dealt could not be handled by cumbersome judicial machinery. It is elementary that the effect of such a requirement can be precisely determined only after the various agencies have complied with it for a substantial period. If the experience of the Interstate Commerce Commission and the Federal Trade Commission, which for a number of years have followed the practice of requiring intermediate examiner's reports, can be taken as indicative, it is submitted that the Morgan case will not result in hampering or destroying the effectiveness of any administrative tribunal.

Moreover, since the Morgan case really only requires that parties be advised of the Government's contentions, without regard to the means selected for furnishing this information, the Morgan case may possibly result in a simplification of the issues involved in many of the complex cases with which administrative agencies are constantly confronted.

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[18] 82 L. Ed. 757, 760.

Public Utility Financing in the Second Quarter of 1938

SECURITY flotations by public utilities aggregated approximately $240 millions[1]

[1] Difficulties which beset the investigator who undertakes to compile data concerning new capital flotations are multiplying. News concerning many issues has, of course, always been fragmentary and fugitive in character, and continues difficult to obtain. Furthermore, an increasing volume of financing now is effected by private sales of securities, by bank loans of substantial amounts and several years' duration, and by intercompany arrangements between members of the same utility system. These transactions seldom are attended by much publicity. Occasionally, loans which properly belong in this tabulation are made by federal agencies. News concerning loans of that character often does not appear in the ordinary channels of financial information. As a result of these developments, the attempt to publish a precise total of new capital flotations will be suspended for the present.

The following reconciliation of the available information concerning capital flotations during the second quarter of 1938 with compilations published by *The Commercial & Financial Chronicle* illustrates the typical problems involved in the preparation of this series. Thus, the *Chronicle* recorded $62,750,425 for April, $40,375,000 for May, and $145,146,945 for June, a total of $248,272,370 for the quarter. The April total includes $380,000 of Gulf Natural Gas Corporation stock units which were still in registration as of July 12, 1938 and had not been offered to the public to that date ac-

(Footnote 1 continued on page 349)

during the second quarter of 1938, a substantial gain over the total of $156 millions[2] recorded for the preceding quarter and a small increase over the second quarter of last year when flotations totaled $223 millions.[2]

The quarter's financing was effected very largely through the medium of long-term debt obligations, the proceeds from which were used principally for refunding earlier long-term debt issues, or for funding short-term loans and advances. Although inadequate data make estimation difficult, it appears that only about $25,000,000 or 10% of the quarter's total, of the financing represented strictly new capital invested in public service industries.[3]

Twenty-five issues, totaling $240,335,025, are reviewed in the remainder of this summary. Of these issues, 21 were in the long-term debt category, one was a short-term debt, and three were stocks. Included among the long-term issues is one having serial maturities of one to ten years.

Private sales to institutional investors continued to play an important role in the flotation of utility securities. Of the long-term debt issues, $55,205,000, representing 13 entire issues and part of a fourteenth issue, was placed in this manner. The one short-term offering, $2,000,000 of New York State Electric and Gas Corporation 4% Serial Notes due in 20 monthly installments, was also placed privately.

Long-Term Debt Financing. The 21 issues in this classification totaled $236,243,600. Seven issues offered for public subscription are analyzed in detail in Table I. The weighted average coupon rate, yield, and cost computed in Table I are the lowest results for these items since the fourth quarter of 1936. The same comparison holds for the weighted average of estimated incidental expenses. The average of 1.73% for underwriters' commissions is the lowest recorded for any quarter since this analysis was started in the first three months of 1936. However, the present quarter's average of this item is not strictly comparable with preceding periods because of the inclusion of the Commonwealth Edison Company debentures which were sold largely through subscription rights. Exclusive of these debentures, the average for commissions was 1.93%, which remains the lowest result obtained during the last three calendar years.

Commonwealth Edison Company stockholders of record (other than Commonwealth Subsidiary Corporation), as of June 9, 1938, received rights to subscribe to 3½% Con-

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(*Footnote 1 continued from page 348*)
cording to advice from the underwriter. The June total included the Commonwealth Edison Company Debentures at $39,083,195; the Company reports that the amount issued was $39,113,600. Further details on this offering are given in the text above. According to a communication from the *Chronicle*, the June total erroneously included the $1,521,000 of Washington Gas Light Company preferred stock as $1,608,750. The June total also included $7,500,000 of East St. Louis & Interurban Water Company First Mortgage 4¼s of 1953, the sale of which was consummated July 1, 1938, according to reports filed with the Illinois Commerce Commission. News current during the second quarter of this year indicated that several other issues may have been sold during the quarter, but the uncertain character of the information probably dictated their omission from the *Chronicle's* totals.

In addition to the $1,000,000 of Central Maine Power Company bonds recorded in the Securities and Exchange Commission Registration Record and news reports indicated that the Company offered $500,000 of common stock to stockholders at $100 per share; unsubscribed shares were to be taken by a parent company at the same price. The bond financing recorded for Kansas Electric Power Company was accompanied by 7,000 shares of common stock to be taken by Middle West Corporation on or before December 31, 1938. The prospectus dated May 26, 1938, describing the bonds and debentures of San Antonio Public Service Company, refers to proceeds of $1,960,000 "to be received" from the sale of 28,000 shares of common stock to a parent, American Light and Traction Company. Another source reported $677,000 of Newport News and Hampton Railway, Gas & Electric Company, First and Refunding Mortgage 5s of 1944. One financial service reported an REA loan of $250,000 to New York State Electric & Gas Corporation. Holding Company Act release No. 1121, June 10, 1938 of the Securities and Exchange Commission reported that Crescent Public Service Company filed an application for approval of the acquisition of a 6% note due June 30, 1940 in the amount of $701,817.31 from a subsidiary, Empire Southern Service Company, for the purpose of effecting a two-year extension of a similar note. The same release revealed that Louisiana Ice and Electric Company filed a declaration covering the issuance of $70,000 of 3 to 5% Serial Collateral Notes due 1939–43, the proceeds to be used to meet part of the cost of additional generating-station capacity. Other releases in the same series refer to numerous additional issues and intercompany deals, the exact status of which is not revealed.

[2] Revised figures.

[3] Compilations of the *Chronicle* indicated that approximately $70 millions represented new capital. This total includes amounts devoted to funding operations.

vertible Debentures at the rate of $5 principal amount per share of stock held. The number of shares so outstanding on the record date permitted a total issue of $39,113,600 of the debentures. A total of $37,781,700 was subscribed by the exercise of the rights, $1,301,500 was taken up by the underwriters at par and offered by them at market prices, and $30,400 was marketed by the Company. The underwriters had agreed to purchase unsubscribed debentures up to a total of $39,083,200 on which amount they received a management fee of 1%. An additional fee of 1% was paid on the $1,301,500 of debentures actually taken by them. The 1.03% shown in Table I as underwriters' commissions represents the ratio of the total of these two fees to the total issue.

The one long-term debt issue scheduled to mature serially was $2,500,000 of San Antonio Public Service Company 4% Notes offered at prices to yield 2.60% to 4.50%.

The record of long-term debt issues placed privately is as follows:

$28,440,000 Consolidated Gas, Electric Light and Power Company of Baltimore First Refunding Mortgage 3¼% Bonds, Series O, due June 15, 1968;

$10,000,000 New York and Queens Electric Light and Power Company First & Consolidated Mortgage 3¼% Bonds, due May 1, 1968;

$5,700,000 Iowa Power & Light Company First Mortgage 4% Bonds, Series A, due March 1, 1968;

$2,250,000 Mountain States Telephone and Telegraph Company 30-Year 3¼% Debentures, due June 1, 1968;[4]

$1,490,000 Bridgeport Hydraulic Company First Mortgage 3¼% Bonds, due 1968;

$1,000,000 Cape and Vineyard Electric Company First Mortgage 4% Bonds, Series B, due March 1, 1968;

$1,000,000 Central Maine Power Company First and General Mortgage 4% Bonds, Series G, due October 1, 1960;

$1,000,000 Kansas Electric Power Company First Mortgage 3½% Bonds, Series A, due December 1, 1966;

$1,000,000 New Bedford Gas and Edison Light Company 3¼% Notes, due October 1, 1951;

$975,000 Alton Water Company First Mortgage 4¼% Bonds, Series A, due March 1, 1963;

$800,000 Southern Indiana Gas and Electric Company First Mortgage 3½% Bonds, due October 1, 1961;

$750,000 Public Service Company of New Hampshire First Mortgage 3¾% Bonds, Series C, due August 1, 1960;

$500,000 Pittsfield (Mass.) Coal Gas Company 4% Notes, due 1948; and

$300,000 Old Dominion Water Company First Mortgage 4% Bonds, due May 1, 1948.

The financing by Consolidated Gas Electric Light and Power Company of Baltimore

[4] Part of a $30,000,000 issue; balance sold to the public (see Table I).

TABLE I. SUMMARY AND ANALYSIS OF LONG-TERM DEBT ISSUES OFFERED PUBLICLY (EXCLUSIVE OF SERIAL MATURITIES), SECOND QUARTER, 1938

Company and Issue (A)	Coupon Rate (B)	Principal Amount (C)	Maturity Date (D)	Month of Offering (E)	Offering Price* (F)	Offering Yield (G)	Underwriters' Commissions* (H)	Proceeds to Company* (I)	Estimated Incidental Expenses* (J)	Net Proceeds* (K)	Cost to Company† (L)
	%				%	%	%	%	%	%	%
Consolidated Edison Co. of N. Y., Inc. 10-Year Debentures	3 1/2	$60,000,000	4-1-48	April	101.75	3.29	1.75	100.00	0.37	99.63	3.54
Commonwealth Edison Co. Convertible Debentures‡	3 1/2	39,113,600	7-1-58	June	100.00	3.50	1.03	98.97	0.83	98.14	3.63
First Mortgage, Series I	3 1/2	33,000,000	6-1-68	June	102.25	3.38	2.00	100.25	0.56	99.69	3.52
Mountain States Tel. & Tel. Co. 30-Year Debentures	3 1/4	27,750,000	6-1-68	June	102.00	3.15	2.00	100.00	0.36	99.64	3.27
San Antonio Public Service Co. First Mortgage	4	16,500,000	4-1-63	May	99.00	4.06	2.25	96.75	0.82§	95.93	4.27
Fall River Electric Light Co. First Mortgage, Series A	3 1/8	2,000,000	5-1-68	May	104.00	2.92	1.90	102.10	1.76	100.34	3.11
Texas Water Company First Mortgage, Series A	6	175,000	1-1-58	May	98.00	6.18	8.00	90.00	6.57	83.43	7.65
Weighted Averages Totals¶	3.51	—	—	—	101.27	3.40	1.73	99.54	0.57	98.97	3.58

* Expressed as a percentage of the principal amount shown in column (C).
† Computed on a bond yield basis using net proceeds per column (K).
‡ See text for explanation of details of computation.
§ Pro rata share of expense on two issues.
¶ Totals, which represent summation of actual amounts, are: principal amount, $178,538,600; offering price, $180,797,600; underwriters' commissions, $3,092,097; proceeds to company, $177,705,503; estimated incidental expenses, $1,012,330; net proceeds, $176,693,173.

is of special interest since it was undertaken for the purpose of refunding two earlier series sold as recently as November, 1934 and April, 1935. The new Series O 3¼% bonds, which were brought out in two blocks, were used to:

a. Refund $18,000,000, Series K, 3¾s of November 1, 1964, which had been sold privately at 96 to six insurance companies in November, 1934; and

b. Refund $10,440,000, Series L, 3¾s of May 1, 1960 which had been sold privately at 100 to seven insurance companies in April, 1935.

Other Financing. The three stock offerings aggregated only $2,091,425. This total is represented by 2,817 shares ($70,425) of South Shore Utilities Associates $1.50 Convertible Preferred, no par; 20,000 shares ($500,000) of Southern California Water Company 6% Cumulative Preferred, $25 par; and 15,600 shares ($1,521,000) of Washington Gas Light Company $4.50 Convertible Preferred, no par.

During the period under review three flotations which did not represent new financing were made, but they accordingly were not included in the quarter's volume figures. These issues were $117,000 of Southern California Water Company First Mortgage 4½% Bonds of 1960 offered for the account of a parent company who had received the bonds in 1937 as a dividend on common stock of the issuer; $1,000,000 of Wyoming Valley Water Supply Company Bonds sold privately by Lehigh Valley Railroad Company to insurance companies; and 7,000 shares of St. Joseph Water Company 6% Cumulative Preferred, $100 par.

Index Number of Volume

The computation of an index number designed to measure monthly the relative volume of financing has been discontinued, temporarily at least. In the first place, an increasing volume of financing is now completed by means of private sales and intrasystem transactions, as mentioned more fully in footnote 1 of this summary. Secondly, information concerning all these transactions, as well as many others, becomes available only after a considerable lapse of time, with the result that the data do not stabilize speedily. For these reasons, almost endless revisions would be required in an index number series based upon monthly or quarterly periods.

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Book Review Department

Urban Land

Mumford, Lewis. The Culture of Cities. *New York: Harcourt Brace & Co., 1938. pp. xii, 586. $5.00.*

In general the same ideas that give form to Lewis Mumford's earlier book, *Technics and Civilization*, are found here. Both books are studies in the structure of the living situation. One relates to western technological development, the other, to the growth of cities. Both take the process of change for granted and the evolution of human forms of living. And both assume that a principle of structure underlies all such processes. Structure influences the dynamics of the situation, not vice versa. Mr. Mumford, in other words, may be called a rationalist.

Technics and Civilization is the more brilliant and novel to the general reader. The present book becomes an impassioned social prophecy. It sees doom for our present urban type of organization. It offers hope in a new regional development now made possible by modern technology. The question remains, of course, not what reasonable people of good will can do with modern instruments in their hands, but what actual people probably will do.

Three types of urban organization are discussed. The mediaeval city was based largely upon principles of internal order. It was a rather loose aggregation of comparatively self-sustaining families. The garden, the small farm within or near the city, the craft, the domestic arts, were cooperative functions in an integral and stable life. The medieval city, Mumford believes, probably gave more satisfactory life to its people than has any type of city since. The baroque city was based on the principles of external order. External symmetry, formal lay-out, the long avenues came in, the great palaces and fortifications. Increasing centralization in the court cities and the decline of the provincial cities took place. The population became more servile, less stable, more dependent for sustenance and wages on the few in control. The present-day paleotechnic city, a massive fungus growing on the coal pile, is unprecedented in power and wealth unevenly distributed. Clotted misery of the slums, smoke, noise. The unstable population is regimented to a system of production which has almost no human relation to what the people consume. Life is broken, disintegrated. Of these three historical types of urban organization, the present city, to Mumford, is by far the worst.

But the future may have another story. Further advance in a technology that has created the disastrous megapolis of today may well produce a regional type of city. Already this is technically possible. The regional city awaits changes in habits of land use and social custom. It will have the creative power of urban life without its present disadvantages. Regional development in city growth involves social changes based on devices such as the internal combustion motor and the electrical transmission of power. But it reaches far into education, the arts, manners, all aspects of life. The regional city is a place where man once more discovers the soil and the natural rhythms of growth and the seasons. It is a place where he can find once more economic security and a life that is integrated in all its functions.

Although Mumford shows that this is possible, and that it is greatly to the advantage of human life, he does not show very specifically how or why such regional development will take place. It is, in other words, another of his Utopias. It has validity as an ideal but does not indicate the necessary powers and mechanisms that may bring it about. This does not diminish the value of this excellent book. We should not ask too much. Rational analysis, valuable as it is, rarely ignites the explosive spark of change.

My friend, Professor W. L. Bailey, student of cities, is less favorable toward this book than I am. He points out, with massive sociological references, that the book is sketchy, that little or nothing in it is new. Such a study as this, Professor Bailey feels should be based on widespread statistical evidences of trends: social, economic, and technological. We should observe, he thinks, what is happening in its huge detail before we jump so easily to what might happen or should happen. He points out that the book, as Mumford admits, is largely an elabora-

tion of the ideas of Patrick Geddes. He feels that, other than in Geddes, Mumford's bibliography is uneven and incomplete.

Professor Bailey is an admirer of the power and growth of modern cities, and I think gives little value to the aesthetic and philosophical considerations which are so important in Mumford's mind. On the other hand, Mumford's book should be taken more as a prophecy or a kind of shining technological poem than a work of science. It is obvious to the reader of any of Mumford's books that the thrill of a newly discovered analogy and the imaginative tension of a revealing metaphor are to him more significant than long ranks of correlated statistical evidences. He goes fast and he has perhaps too much confidence in his ideas. His data are marvelously pat and docile in respect to his conceptions; as they always are in minds where the poetry and message of things outweigh their crude character of fact. He thinks largely by a process of brilliant analogies. This is important in general intellectual life but it is not a large part of work-a-day science.

The book indeed should be taken for what it is: an illuminating and poetic interpretation of life as we find it in three great types of urban organization, along with a ground plan of hope for the future.

BAKER BROWNELL
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Smith, G. Burchard. NEW YORK ZONING LAW AND PRACTICE. *New York: Baker, Voorhis & Company, 1937. pp. xiv, 552. $7.50.*

Rathkopf, Charles A. THE LAW OF ZONING AND PLANNING IN NEW YORK STATE. *New York: Grosby Press, 1937. pp. vii, 415 (with pocket supplement). $7.50.*

On the heels of Edward Bassett's scholarly book, published by the Russell Sage Foundation (reviewed in this *Journal*, February, 1937, p. 106) come two "practical" books by practicing attorneys, put out by commercial law-book publishers. Zoning has arrived, like price-fixing and labor relations. The Rathkopf book bears this legend upon its title-page: "A book written primarily for laymen (sic) members of zoning and planning boards . . . to guide them through the intricate legal pitfalls present in every zoning and planning problem and also designed to furnish authoritative law to members of the bar . . ." Slightly Elizabethan in flavor, but also reminiscent of Indian Joe's Snake Oil Medicine, isn't it?

Heaven knows, lay members of planning and zoning boards need guidance, are pathetically eager for guidance; but how a book like this can be of any help to a layman, it is beyond me to see—because most planning officials are laymen not only vis-a-vis the law but planning and zoning. Of what earthly use is it to set forth general platitudes: "The plan adopted must be such as will not unreasonably discriminate against property . . ."; "The zoning ordinances must be reasonable"—buttressed by portentously long lists of citations of cases—when the officials need a realistic picture of what *is* reasonable?

The Rathkopf book is poorly organized; forbiddingly printed in the horrid format used for briefs, so that two sentences of text with the supporting citations occupy a whole page; and contains only 140 pages of "authoritative law." The rest is reprints of the relevant enabling acts, sample ordinances, and forms for administration and litigation.

The Smith book is a much better job of its kind, better organized, more complete, although its appendix material deals too exclusively with New York City. Accepting it for what it purports to be, I find it frequently repetitious, e.g., the facts in the same series of cases are set forth on pages 39–41 and 57–61. Moreover, it does not rise above the level of the hornbook: "on the one hand," zoning is in derogation of common-law rights and must be strictly construed; "on the other hand," it is settled that zoning when properly used shall receive a liberal construction.

Section 18 (p. 80) is headed "A Zoning Ordinance Cannot Abrogate a State Law"; of the cases recited, one is said to hold that a zoning ordinance cannot forbid a structure approved under the state health law; another is quoted as holding that a permit from the state department of mental hygiene does not override a local zoning ordinance. Is not the reader entitled to the benefit of the author's reflection and cogitation in trying to reconcile these cases or explain the reasons for the different conclusions?

Fundamentally, I question the premises

which underlie these books. I do not believe that a picture of zoning practice can be given by collecting notes on court decisions alone. Thus, in support of the statement that zoning must be based upon a well considered plan, Smith presents digests of nine cases in which a court said that the treatment of the complainant's property showed that there had *not* been a well considered plan; but there is no affirmative picture (or even reference to the literature) of the elements of a well considered plan. There are forms for legal notice of hearing, for law suits, but no forms of applications for permits, or of certificates of occupancy. Neither book gives a picture of the interesting possibilities of the original jurisdiction of the board of appeals. The only use I see for these expensive books is to furnish precedents which an attorney can cite if he is (a) supporting, (b) opposing the operation of a zoning scheme. For this purpose the Smith book is far better; but neither will contribute to the development of a coherent body of zoning law or practice.

CHARLES S. ASCHER
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Land Resources

Heske, Franz. GERMAN FORESTRY. *New Haven: Yale University Press, 1938. pp. xxv, 342. $3.00.*

German Forestry represents a very real effort of the Trustees of the Oberlander Trust and the members of the Carl Schurz Memorial Foundation to provide American citizens with an authoritative account of German forestry as an institution, and how it is being reshaped to meet the needs of a nation undergoing severe economic stresses and basic political changes. Dr. Heske, Director of the Forstliche Hochschule at Tharandt, has not only had long experience as a forester in Germany, but he has been a forest consultant to the Turkish Government and has managed large forest estates in India.

The book has a preface by Dean Henry Solon Graves of the Yale School of Forestry and an introduction by Dr. R. B. Goodman, progressive Wisconsin lumberman and Chairman of the Wisconsin Conservation Commission.

The text is divided into two main parts—German Forests and Forestry, and German Forest Policies. To most Americans, German forestry possesses something of the legendary-orthodox forestry practices deeply rooted in the past. Part I confirms our legendary beliefs, by furnishing a wealth of historical and statistical data, presented in a most readable style.

In Part II, a discussion of German forest policies, the reader is given a close-up of the human forces that have made German forestry what it is; and, what is still more alluring to the modern student of political economy, the forces that stop not even at so slow a process as forest growth in attempting to establish a new concept of government and "culture."

A strong case is presented for the inevitable ascendancy of federal or national control of policies and management within the communal, private, and state forests. The German's concept of the employer-employee relation is analyzed, together with an exposition of individual enterprise as a social organism—a distinctly Nazi philosophy which permeates even the ranks of the forest managers as well as the forest-conversion industries.

There is evidence that much must still be done in the adjustment of population to the land, but we learn that this adjustment is motivated by a desire to offset a declining birth rate in the cities, on the assumption that the rural birth rate will always be high. In this adjustment, some land clearing from present forest cover is certain.

There is recent legislation—or shall we more properly say an edict—described as the Law of Forest Races, which indicates that the heavy hand of the law will be laid against the processes of reproduction on the part of any trees or forests which do not measure up to minimum biological standards—the penalty to be exacted from the landowner or the forester, not the errant tree. Taxation, insurance, and forest credits, all live issues which find their counterpart in American forestry problems, are admirably treated, though the forester-reader may be somewhat surprised to find forest protection discussed in the part dealing with policies, instead of under forests and forestry where it more properly belongs.

The original text was written in German. The English translation is the work of Professor A. B. Recknagel, Department of Forestry, Cornell University, and Mr. Wil-

liam N. Sparhawk, of the United States Forest Service.

FRED B. TRENK

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Bercaw, Louise O. and Hannay, Annie M. BIBLIOGRAPHY ON LAND UTILIZATION, 1918–1936. (U. S. Dept. of Agriculture, Misc. Pub. No. 284.) *Washington: Government Printing Office, 1938. pp. 14, 1508. $1.50.*

Culver, Dorothy C., compiler. LAND UTILIZATION: A BIBLIOGRAPHY. *Berkeley, Calif.: Bureau of Public Administration, University of California, 1937.* 2 vols. (mimeographed). *$1.00.*

These extensive bibliographies on land utilization, both recently published, cover the whole field in a most comprehensive manner. In fact, the two together comprise "the last word" on the subject. *Bibliography on Land Utilization* has been compiled under the direction of Mary G. Lacy, Librarian of the Bureau of Agricultural Economics in cooperation with the Land Utilization Division of the Resettlement Administration. This "Bible" contains 1,508 pages of fine print, listing 7,343 references with full bibliographical information in every instance and lengthy annotations in many cases. A particularly valuable feature is the 217-page, double-column index by author and subject; a detailed table of contents helps in understanding the arrangement of the book. References to articles in all foreign countries from Africa to Yugoslavia are included. So comprehensive is the work that the table of contents reads like an atlas. While the introduction explains that "it contains *selected* references to the literature on the economic aspects of land utilization and land policy," it seems as if every article ever needed will be found in this splendid list.

The two-volume bibliography by Dorothy C. Culver is an attempt to bring together in one publication all references, from books as well as periodicals, to the utilization of land. Volume I was first issued in 1935 and reissued November 15, 1937 with typographical corrections. Items are arranged alphabetically by author under subject classifications. In some instances scope and contents of the items are given in considerable detail; in all instances full bibliographical description is supplied.

The two bibliographies are reference books of great use to those working in the problems of land, its conservation, and utilization. They should find a place on the shelves of every library, big and little, because of their comprehensive coverage of the whole field of land utilization. Of the two compilations the one prepared in the Bureau of Agricultural Economics is the more useful because of its voluminous index.

CARRIE MAUDE JONES

Librarian, National Association
of Real Estate Boards

Schmidt, Carl T. THE PLOUGH AND THE SWORD: LAND, LABOR AND PROPERTY IN FASCIST ITALY. *New York: Columbia University Press, 1938. pp. vii, 197. $2.50.*

Mr. Schmidt paints no rosy picture of rural Italy. To him, Fascist progress means subjugation to bureaucracy and the landed gentry. Promises are for the masses. Actions are directed toward benefits for the landlord. Under the corporate state, standards of living have declined. Poverty has increased in the rural sections.

The publication attempts to cover the whole field of agriculture in its relation to the government. In this review, however, emphasis is placed upon reclamation, land ownership, and tenancy.

Agricultural reform in Italy has been a subject of parliamentary debate for generations. Immediately following the war, the farm laborer and the small holder, through organization and use of the strike, won some substantial victories. These victories were short-lived. The leaders were divided. They lacked the will or the courage to consolidate their gains. Fascism appeared on the scene with its hyper-nationalistic appeal enforced by terrorism. Property owners of all classes —rural and urban—flocked to its standard. This was the beginning of state control of farm operations.

Reclamation is a broad plank in the agricultural platform of Fascism. It is not the first to attack that problem. Emperors, popes, princes, and kings have for centuries linked their names with land reclamation in Italy. Extensive land reclamation work was not undertaken, however, until the last half of the nineteenth century when large areas were reclaimed in the Po Valley through

private support and initiative. Since the unification of Italy, the government has participated on an increasing scale.

Modern land reclamation is based upon the "Baccarini Law" of 1882 which established guiding principles for private and government participation. This legislation was gradually supplemented until 1912 when all major elements of the Fascist program were incorporated. The blackshirts were rather slow in becoming reclamation converts. Not until the "Mussolini law" of 1928 did reclamation become an ambitious part of Fascist doctrine. This law contemplates the expenditure of 7,000,000,000 lire over a period of 14 years. Roughly ⅓ is to be advanced by the land owners and ⅔ by the government. There are indications that far more projects have been initiated than can be completed within the limits of these funds. The author predicts wasteful and costly abandonments.

Official claims of accomplishment are difficult to appraise, since every move pertaining to improvement of the soil comes under the classification of reclamation activities. It is certain that work so far completed has done much to improve rural health conditions, especially in malaria regions. It is equally certain that government promises regarding land for the landless can never be fulfilled by this process. Only 8,875 families were settled on reclaimed lands during the seven-year period 1930–6.

Agricultural labor has not fared well under the corporate state. The length of the working day has increased, wage rates declined, and chances for employment are reduced. The tendency for the government is to increase share-tenancy—a species of serfdom under existing forms of contract.

Land ownership is still concentrated in relatively few hands. Of the 4,200,000 farm enterprises, 36% are less than one hectare in size, and 55% are from one to ten hectares.

For the rural masses, the discipline of Fascism is the discipline of poverty.

Mr. Schmidt's treatise is no empty tirade or emotional outburst. Copious footnotes and a generous supply of documentary evidence, much of it from official sources, are brought to the support of his conclusions.

Asher Hobson

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Public Utilities

Stotz, Louis (Alexander Jamison, collaborator). History of the Gas Industry. *New York: The Author, 1938. pp. 534. $3.50.*

The author's interest centers in the commercial, personnel, and public relations aspects of the gas business of the United States. He served as Secretary of the National Commercial Gas Association until it was merged in 1918 with the corresponding technical association to form the American Gas Association; and he thereafter occupied a similar position with the new organization.

In the first six chapters, which deal primarily with the early history of the gas industry in certain larger American cities, the author has, in the main, rewritten works like that of Rice for Chicago and of Collins for New York. After another six chapters on general developments since 1880, chronological treatment is abandoned. The author then devotes a dozen separate chapters to the history of as many different types of gas appliances. A few chapters on personnel and public relations activities follow. The last half of the book is given over in about equal portions to problems of natural gas and public utility regulation. The latter topic appears to be the work of the collaborator, Alexander Jamison, a lawyer with considerable experience as company counsel in public utility rate cases. The book has no index or bibliography.

Lyle Bryant

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Bernstein, E. M. Public Utility Rate Making and the Price Level. *Chapel Hill: University of North Carolina Press, 1937. pp. x, 142. $2.50.*

"It is the purpose of this study to show how the rate making rule and its procedure were developed, to consider the difficulties that were experienced under this rule, to discuss the new methods of rate making that commissions used during the recent period of rapid fluctuation in prices, and to offer a reasonable solution for the rate making problem" (p. vi).

Of the ten chapters, the first three sketch the rate-making problem, the rule of rate-making, and the general aspects of price level, valuation, and return. The remaining seven chapters consider war-time regulation and rate-making; reproduction cost at average unit prices; the use of corrective indices;

the split inventory; the fair rate of return; rate-making in prosperity and depression; and a proposed solution of the rate-making problem. Written by an economist, the discussion makes little attempt to weigh the legal issues involved.

Little new ground is broken in discussing the development of rate regulation and the difficulties experienced by commissions in operating under the rule of rate-making. Largely for reasons of administrative expediency and to avoid fortuitous fluctuations in utility earnings, the author favors the prudent-investment basis for valuation. While he calls attention to the theoretical merit of reproduction cost in affording an approximation of the competitive distribution of economic resources, Professor Bernstein correctly points out that this virtue belongs largely to the cost of reproducing the service by the most up-to-date methods, rather than to the cost of reproducing the existing plant standard, so commonly used in valuation. He makes no attempt to estimate the degree of actual divergence that has existed in different public utility situations between these two conceptions of the cost of reproduction. Interesting calculations are introduced (p. 124) which show that the lag in adjustment of investment cost to current price levels is less than might be supposed; e.g., with an average asset life of 20 and a rate of increase in net investment of 5% per annum, prices of the last five years would have a weight of 52% in determining the "fair value" of a property. A valuable service is performed in describing the rate-making policies of courts and commissions during the past few years. In general, however, it seems to the reviewer that, while the volume will be helpful to those previously unacquainted with the subject, it is too descriptive and general to be of material aid to those already versed in the extensive literature of rate control.

As a solution of the problem of rate regulation the author recommends the establishment of a prudent-investment basis for valuation and a common-stock basis for the return (treating interest and preferred dividends as operating capital charges). He proposes that initial valuations be determined by joint committees representing the commissions and the companies, subsequent additions to be added at cost, with deductions for depreciation and retirement as shown by the reserve accounts. The rate of return on common stock is to be fixed at a "rate that will maintain the market value of the common stock of a representative utility company at par or at the price at which the commission authorized the issue" (p. 131). There is no consideration of the problem of selecting a "representative" company, nor of the treatment of companies whose existing capitalizations either do not conform to the valuation base or are qualitatively of such a character that the price of the stock is necessarily below the permissible level. Nor does he consider the difficulty of maintaining the price of common stock in depression years without allowing a level of earnings which would necessitate an inverse cyclical relationship between the level of public utility and other prices. The desirability of such a result is surely open to question. The adoption of franchises embodying the new plan is to be facilitated by the threat of public competition; the acceptance of the plan would guarantee the absence of public ownership save through the purchase of the existing property at a price equivalent to the rate-base.

John D. Sumner

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Public Administration

Gulick, Luther and Urwick, L. Papers on the Science of Administration. *New York: Institute of Public Administration, 1937. pp. 195. $3.00.*

This is a valuable collection of papers by 11 leading writers in the United States and abroad on principles of administration in government and in business. The contributors are Luther Gulick, L. Urwick, James D. Mooney, Henry Fayol, Henry S. Dennison, L. J. Henderson, T. N. Whitehead, Elton Mayo, Mary P. Follett, John Lee, and V. A. Graicunas. The papers deal with principles of organization, control, coordination, functionalization, and so forth. The immediate reason for publication of the volume was the fact that the papers were not available in the libraries in Washington when they were needed by the President's Committee on Administrative Management. We are thus doubly indebted to President Roosevelt for

stimulating contributions to the science of administration.

The title of the volume is both suggestive and provocative. All the authors believe that there is a science of administration and that there are certain principles of general validity which can be applied to increase efficiency of operation. There is considerable similarity in the conclusions they reach, which in itself is some evidence of the existence of a science. However, even though the general boundaries are fairly well staked out, the detailed areas are by no means all filled in and the language is still vague in many places. Much still remains to be done, particularly in the collection of facts. The encouraging thing is that we are making real progress toward formulation of a body of administrative principles. It is interesting to contemplate the day when we shall know certainly the best way in which to organize and administer. When that day comes, if administration is really a science, will not the government be able to administer quite as efficiently as private industry, or is willingness to apply science equally as important as scientific knowledge itself? The farther government enters into business, the more important this question becomes. There is at present a very considerable body of knowledge about administration which government, as well as industry, has not seen fit to apply.

Of the 11 papers, "Organization as a Technical Problem" by Urwick, "The Administrative Theory of the State" by Fayol, and "The Effects of Social Environment" by Henderson, Whitehead, and Mayo seem particularly significant. Urwick is the first person to make really clear to me the meaning and importance of the staff principle. Drawing upon the organization of the British army, he regards the staff as "those who assist the commander in the execution of his functions of command" by conveying the commander's orders to his other subordinates, anticipating problems of coordination and issuing instructions for their solution, collecting information for the commander, and submitting reports to him to indicate whether his orders are being properly carried out. "Thus it may be said that, though he [the staff officer] commands no one, he assists the commander to command everyone, that while he provides nothing but information, yet he arranges everything so that the fighting troops and services whose function it is to 'execute' may be enabled to do so with the maximum of unity and the minimum of friction" (p. 63). The importance of the principle is that it enables the commander to delegate to his staff the task of making the specific and detailed arrangements for carrying out the general plans formulated by the commander, as well as for securing coordination, and thus escape intolerable burdens and avoid violation of the principle of the span of control. It is clear that the staff principle in this sense has not been understood or applied by either government or business in the United States. The President's Committee on Administrative Management apparently did not understand it. Urwick's analysis may prove of great practical value.

Fayol's remarks about the proper administration of government business enterprises are illuminating, even if he did not foresee the development of government corporations. The paper by Henderson, Whitehead, and Mayo is one of the most intensely interesting I have ever read. It describes the results of an experiment in which the efficiency of five girl operators was found to increase as they became integrated socially, one might almost say spiritually, into a group. Modification of the hours of work, introduction of rest periods, and other similar changes all were of minor effect in comparison with the results of social integration into a group. The experiment indicates something of the part that group morale plays in efficiency. It opens materially the crack of the door behind which still lies hidden much of the science of administration.

The editors are to be congratulated in bridging international boundaries as well as the artificial boundaries between public and private administration in bringing these papers together. The principles of administration are universal.

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